WAR FINANCE

BY

J. SHIELD NICHOLSON,
M.A., SC.D., LL.D., F.B.A.
Professor of Political Economy in the University of Edinburgh

SECOND EDITION

WITH THREE ADDITIONAL CHAPTERS

LONDON:
P. S. KING & SON, LTD.
ORCHARD HOUSE, WESTMINSTER
1918

Dedicated

TO THE MEMORY OF

GEOFFREY,

MY ONLY AND DEARLY BELOVED SON,

2ND LIEUT. ROYAL FLYING CORPS,

WHO DIED ON THE 22ND AUGUST, 1917,

AGED TWENTY-THREE,

OF WOUNDS RECEIVED ON THE PREVIOUS DAY

WHEN FLYING OVER THE GERMAN LINES

PREFACE TO THE SECOND EDITION

SINCE the publication of the First Edition of this book in the beginning of this year no changes have occurred in the general financial situation which call for a corresponding revision of the main argument and conclusions.

The old economic warnings have been confirmed more abundantly as shown in three new chapters.*

The first of these (Part II., Chap. XLIV.) deals with *Bolshevism.* There has never been in the history of the world a more striking example of the dangers of disregarding fundamental economic principles. *Occurrite morbo.*

The "Abandonment of the Gold Standard" (Part I., Chap. II.) has become more pronounced. The second new chapter (Part II., Chap. XLV.) describes the continued abnormal increase in the various forms of token money, notes and credit. In Appendix B to this chapter the latest returns are given of the issues of bronze and of silver. Quite recently (August, 1918) the rate of increase in the issues of Bank of England notes and currency notes has become much more marked. The known export of a large amount of these notes is causing concern, as the ultimate destination is probably Germany for use in a future peace offensive.

This continued inflation of British currency and

* Some of the materials have been published in the *Scotsman*, and I am obliged for the privilege of republication.

credit has been associated with further *specific* depreciation. In the beginnings of the inflation the sceptical banker asked, Where is the premium on gold? After many attempts at concealment the premium has come into the open. It was authoritatively reported in the *Times* (June 18, 1918) that South African gold for trade uses commands a premium of some 35 per cent. as compared with the British standard official price. In technical language the market price is so much above the mint price. The premium on gold as a commodity is one recognised measure of *specific* depreciation. (See Appendix A, Part II., Chap. XLV.)

Specific depreciation of any national currency is also shown by its relation to other national currencies which have retained their normal convertibility with gold. Compared with Holland and Spain the British currency has made new records in depreciation during the present year. A similar fall in relation to the United States has only been prevented by special loans.

Specific depreciation is of direct practical interest only to those concerned in foreign trade and finance or in the industrial uses of gold. Every one, however, is concerned with the *general* depreciation of the pound sterling or the fall in its purchasing power as shown by the general rise in prices.

It is true that the rise in prices has been somewhat retarded by the Governmental control of important commodities. But it is difficult to see how this control is to be maintained and extended in face of the continued growth of war bonuses to labour of all kinds, accompanied by a continued increase of currency.

It was declared long ago by representative leaders of labour that if the cost of living were controlled the demand for bonuses would cease. In spite, however, of the great work of Lord Rhondda and

the Food Ministry, war bonuses have increased rapidly.

It was also said that the control of profits would at once control the bonuses. But here again the Government has itself taken over important industries, and yet the demand for bonuses seems rather to have been stimulated.

When the State takes over industrial capital it takes over also its burdens—and one of the greatest of its burdens is the distrust with which labour regards capital. In political theory Government is omnipotent, but in the actual management of labour it is much more feeble than the private employer. Government in this country yields much more easily to economic pressure, and labour seems to regard every bonus extracted from the State as so much taken from the old enemy capital.

The recent history of the coal industry is instructive. The Government took over the coal mines in February, 1917. A scale of prices was fixed to meet the necessary capital charges and to give fair wages to labour. In October, 1917, and again in June, 1918, the price of coal was raised in order to give war bonuses to labour.

The real meaning of this rise in price is that the British Government imposes a tax on coal to benefit a favoured class of workers.

An *internal* tax on coal is one of the worst. Coal is a necessary not only to consumers, but to producers. Adam Smith even approved of a *bounty* on coal (instead of a tax) so as to lower the price in places distant from the pits.

An *export* duty on coal was indeed approved of by the same Adam Smith because he thought the home consumer should have a preference!

But in the present War who would approve of an export duty on the coal sent to France and Italy? Germany has seized the best of the French coal

regions. Are we to celebrate the entry of the fifth year of war by an export duty on coal to France?

In Italy the German propagandism against this country was fostered largely by the high prices of British goods, especially coal. The British Government has started recently in Italy a literary counter-propagandism. How can it prosper if the price of British coal is again to be raised?

Coal is only one example. Other favoured classes of the workers have been allowed to assume the right of private taxation. Recently the bakers in Scotland have asked for a rise in the price of bread to cover a rise in wages.

It is of the highest importance that the effect of rationing and the control of prices should not be dissipated by bonuses.

Such as it is, control of prices is the only remedy or palliative of inflation.

The war bonus has been spreading both upwards and downwards. The civil servants, both national and municipal, have had their bonuses; so have the little boys and girls who are making hay before they are caught by the new education.

The worst of the war bonuses is that the head of the queue gets a second dole before the tail reaches the shop door. The inequity of the war bonus is well shown by the case of the National Shipyards. If labour is released from the army it will only be allowed by the Unions to work at civilian rates of pay. At first sight a most just proviso, but what can we think of a system of wages in which it is taken for granted that civilians must always be paid at higher rates than the military on active service?

Throughout the volume it has been constantly maintained that capital has had its bonuses no less than labour. In a period of inflation capital actively employed first feels the benefit of the rising prices just

as the consumer feels the burden. Apart from this general prosperity of capital the public has been startled by the exposure of some of the particular bonuses to capital by the Committee on National Expenditure. Compared, however, with the aggregate war expenditure the total losses through these particular "errors" of all kinds are relatively small and most of them will be written off under allowances for "the sanctity of contracts" and the customs of trade.

The cumulative effect of the over-payment of capital (over-payment, that is to say, having regard to the sacrifices demanded from all in a war for national existence) is best realised by the growth of the burden of the national debt. The aggregate amount of debt has been largely increased by the over-payment of the services of capital, and the interest payable on this sum total is far higher than it ought to have been.

These topics have been handled in various chapters of this book * and in this place it is only necessary to refer to the present situation. At last the growth of the national debt (with the interest on it) is beginning to cause grave concern to all who realise the meaning in terms of taxation.

Unfortunately the number is still relatively small, and that big baby, the general public, is still kept from crying by two kinds of soothing syrup both very well advertised.

First, the probable amount of the debt is greatly under-estimated. It is assumed that when fighting stops borrowing will stop. In the face of German disrespect for treaties how long must we allow before our naval and military expenditure is reduced to peace level? How are all the unknown elements in demobilisation to be met? How are we to recon-

* Pp. 97, 313, 371, 402.

struct the lost industries and the devastated lands of our allies? When can our allies repay our loans? How are we to fulfil the promises to labour of general advancement after the War? When will exports again balance imports?

Until the normal expenditure is covered by normal revenue there must be an increase of debt.

Secondly, just as the debt is under-estimated, the means of payment are over-estimated.

Vague talk of the unlimited resources of the British Empire must be translated into terms of taxes. Taxation is the process by which these resources are utilised for Governmental purposes. It is clear that our old peace taxation will fall far short of normal expenses after the War. The increase in peace charges and the charges for the new war debt can only be met by heavily increased taxation.

What are the new taxes to be?

Any great increase of indirect taxation is at once ruled out because indirect taxes, to be productive, must fall on the masses of the people, and to tax the masses in the "new world" after the War is "unthinkable."

Direct taxation means taxation of income or capital. The rise in the income tax during the War has magnified its inequities. There is a general agreement that the present high rates ought not to be continued (still less increased) without drastic reform. The kind of reform, however, that is most pressed is the steepening of graduation until at the limit the millionaire becomes his own book-keeper with a reasonable living wage.

Unfortunately, taxation of this kind and degree will tend to destroy the sources of the higher incomes and eventually the yield to the tax itself. In order to prevent a chronic wasting disease of this character some of our tax-reformers advise a surgical operation. They suggest a direct levy on capital to

reduce the national debt to an amount manageable by ordinary, though heavy, taxation.

A new chapter (Part II., Chap. XLVI.) has been introduced under the title "The Payment of War Debt by the Taxation of Capital," showing some of the dangers and difficulties of the proposed "levy on capital."

The dangers of the proposal are of two kinds: both of the gravest importance as affecting the War itself.

The first danger is the support given to the popular delusion that the war debt, however great it may be, can be easily met from the wealth of the wealthy, that it is for the wealthy to choose between taxation of their income or of their capital, and that the masses of the people can go on comfortably with their war bonuses.

One of the persistent aims of this book has been to expose this delusion. The war bonuses to labour and to capital have probably more than doubled the real burden of the war debt. This war debt, after a certain point is reached, becomes an increasing source of weakness in the effective conduct of the War.

The second danger of the proposed levy on capital is that the owners of capital, especially of large capitals, will see in it—however carefully it may be guarded by declarations — the beginnings of national repudiation and of the confiscation of private property, the end of which things is Bolshevism. The root idea at the basis of the premature peace such as is adumbrated by Lord Lansdowne seems to be the fear of social revolution.

If some parts of this book have seemed pessimistic regarding the accumulation of public debt and the estimates of national resources, the excuse is the haunting dread lest money interests and money mismanagement may prevail over moral duty in the last stages of the struggle.

The material ravages of the War can be restored—not easily, it is true, but with a great united effort. Premature peace with the crimes of Germany and its rulers unpunished will cause irreparable moral loss.

J. S. NICHOLSON.

UNIVERSITY OF EDINBURGH,
August, 1918.

POSTSCRIPT.—Since the above was written all the financial signs of inflation are increasingly adverse:—The *Economist* index number, the excess of imports over exports, the currency notes, the notes of the Bank of England—all have made new records.

The supply of all kinds of commodities and of services is still falling. Coal is severely rationed. Passenger trains are more restricted. The list of the shortages of the necessaries and conveniences of life might be indefinitely extended.

The only thing that steadily increases is money in all its forms. The latest sign is a threat of the issue of five-shilling notes.

There is a constant struggle to get hold of the new money. The great victory of Marshal Foch has been celebrated in this country by a portentous outbreak of strikes and threats of strikes in employments of the greatest national importance.

The latest official remedy is to make the wages of the most favoured and troublesome classes rise automatically with the rise of prices. If the unrest in all the other classes is not to be increased it is to be hoped that effective means will be taken to check the rise in prices.

J. S. N.

22 *September*, 1918.

PREFACE

In September, 1914, Mr. Lloyd George, then Chancellor of the Exchequer, stated that, as in the Napoleonic war, we should win in the end by our financial strength. Germany might get the first hundred millions as easily as Britain, but Britain had far greater staying power. It is not (he said) the first hundred millions that count, but the last.

In September, 1917—just three years later—Mr. Bonar Law, Chancellor of the Exchequer, stated in a public speech that without the aid of the United States the financial position of the Allies would to-day be very disastrous.

Did Mr. Lloyd George mean that the British Empire could hold on until the intervention of the United States? Certainly not.

Perhaps it may be thought that Mr. Bonar Law exaggerated. Where, it may be asked, are the signs in this country of financial disaster or of the need of American support?

The recognised test of national financial strength is national income. The imposing figures—too often paraded at the beginning of the War—of the capital value of the United Kingdom or of the British Empire are all based on estimates of national or imperial income.

Does the national income of the United Kingdom show any signs of falling off owing to the exhaustion of the War? Are the signs (such as they are) suggestive of coming disaster?

On July 26, 1917, the Financial Secretary to the Treasury stated in the House of Commons that the gross income brought under the notice of the Inland

Revenue for the year 1913–14 was £1,167,184,289, whilst for the year 1916–17 the gross income (estimated) was £1,670,000,000. Of course the estimate is not on quite the same basis, but roughly it means that the income of the richer classes has increased by about 50 per cent.

Incidentally, it may be observed that the total revenue from taxation for the last financial year (1916–17) was about the same as this increase since the War in the gross income of the richer classes.

Unfortunately the Labour Department of the Board of Trade has not given a similar estimate of the remaining gross income of the nation, but it is probable that the increase in family earnings of the working classes is over 50 per cent. Since February, 1915, there have been published every month in the *Labour Gazette* records of increases in wages. Here is the latest available: "The changes reported as taking place in August, 1917, affected nearly 1,400,000 workpeople and resulted in a net increase of nearly £180,000 per week." * This gives more than 2*s.* 6*d.* per head per week.

The increases in earnings not recorded in the *Labour Gazette*, but revealed incidentally in the police courts in proceedings against women and children, show still greater signs of prosperity. A soldier's wife, with over £400 a year from allowances and family earnings, cannot control a child of fourteen, who earns £2 a week. A munition maker of twenty, whose earnings average £8 per week and sometimes reach £12, is fined a week's wages for not paying his income tax.

The director of the economy campaign asserts that his greatest difficulty is found in the high money wages and family earnings of the workers in munitions and other industries favoured by the War.

The truth is that the growth (measured in money)

* *Labour Gazette*, September, 1917, p. 312.

of the national income during the three years of War has greatly surpassed all the records of peace.

Nor, when we turn to the Governmental expenditure do we discover any signs of national distress. Quite the contrary. Every day we read of increases in public expenditure, not only for the conduct of the War, but for the benefit or comfort of the people. The bureaucracy grows apace. New offices of all kinds are multiplied and manned (or womanned) by increasing staffs with increasing wages. Where are the signs of a depleted Exchequer or of coming disaster (but for the support of the United States)?

Those who are callous to generalities may perhaps be pricked by a particular instance. The four-pound loaf nearly touched a shilling. (In the Napoleonic wars it nearly touched two shillings.) A benevolent Government became concerned for the standard of comfort of the working classes and for the efficiency of their labour. A great effort was made to reduce the price of the loaf to 9*d*. The cost of the necessary subsidy to the nation is estimated at anything from £20,000,000 to £40,000,000 a year. We may be sure that, as usual, the maximum will be the minimum. Forty million pounds a year is about one quarter of the whole revenue from taxes before the War.

This example of Governmental economy is full of lessons in simple arithmetic. Here is another. According to the Food Controller's reckoning a family of five is supposed to consume five four-pound loaves per week. According to the figures quoted above, about a million and a-half of the workers received per head, in August, bonuses of more than 2*s*. 6*d*. a week. The loaf has risen sixpence from the pre-War figure, or for a family of five the cost of bread is 2*s*. 6*d*. greater—that is, just about the bonus per head of the workers mentioned.*

* *Cf.*, Part II., Chap. XI., on "Gluttony in War-Time," p. 446.

It is perfectly plain that an allowance in aid of old-age pensioners and others who really feel the rise in the price of bread could have been obtained at a fraction of the cost. As it is, the subsidy given where it is not needed encourages the waste of bread when more than ever economy is necessary.

In the outpouring of the public money everyone has regretted that the men actually doing the fighting got nothing. An official calculation, given recently in the House of Commons, put the pay of the common soldier at about 30*s.* a week. Of this sum 20*s.* per week was for board and lodging! The true joke is no joke. Board and lodging in the trenches—20*s.*! When the War is costing us eight millions a day, no one would grudge spending a million a week more on raising the pay of the fighting men. But again the Government made no discrimination between active and passive service in the distribution of £50,000,000 (for the first year).

Coincidentally with the belated rise in the Navy and Army, the munitioners receive not only an increase of pay shading down from 2*s.* 6*d.* a day (against the Tommies' 6*d.*), but are relieved of the discipline that curbed their freedom of movement, and are encouraged to move by free railway passes. This at the very time when Sir W. Robertson is saying that we can only win the War with the greatest effort of economy and efficiency behind the lines.

But to return to the main question—Can we suppose that we really need financial assistance from the United States when the national income has been growing by leaps and bounds, and we are throwing away millions of public money without taking the trouble to do a few simple sums? Is it not plain that we are still a very wealthy nation? If we can still afford to spend eight millions a day

why should all our cheerfulness be spoiled by talk of American assistance? Last year we raised a thousand millions in a big loan. Why not raise another thousand this year? A thousand millions (we are assured) is less than one year's income of the richer classes. Most of the money borrowed is poured out within the country and can be mopped up again by another loan, and so on. After the War boom we may look forward to a peace boom. Borrowing for reconstruction will follow the borrowing for destruction. Still more abounding prosperity may be expected. We shall show to a wondering world that the glories of the fabulous Golden Age are as nothing to the real glories of our actual Age of Paper. Such is the optimist's picture of the present and future state of the nation.

Why, then, should the Chancellor of the Exchequer be so gloomy when all the signs are so favourable?

The answer is that these apparent signs of financial strength—the increase in national income, the rise in wages and in profits, the growth in public expenditure of all kinds—these signs of prosperity, when properly interpreted, are not signs of vigour and strength, but of weakness. The glow is not the glow of health, but of fever. The old name for the old malady is inflation. The beginnings of it, as with many other diseases, are pleasant—the end, if it is not checked in time, is industrial anarchy, such as we see in these last days in Russia.

A disease is none the less a disease if called by another name. Inflation is a word with unpleasing associations—it suggests contributory negligence on the part of the sufferer. It is much nicer to say that the malady (if it is a malady) is caused by the expenditure of borrowed money and that the extravagant expenditure of loans is the necessary outcome of war. But where does the borrowed money come from? If it is not old money, it must be new

money—new money manufactured to meet the expenses of the War. So we come back again to inflation.

In other words a public loan can only be expended on the multitudinous forms of labour and capital by being pulverised into the different kinds of currency required—cheques for the contractors and notes and silver for the men. (See Part I., Chap. V., on the Statistical Aspects of Inflation.) Those who deny inflation must explain how else the money, *i.e.*, the spending power of the State, is obtained. If it is not got from taxes, or from real savings and economies; or from sales of exports, or returns from foreign investments, and the other resources of peace, where does it come from?

The financial question of the most vital importance at the present time is the great and continuous rise in prices.

A rise in prices really due to scarcity, even of necessaries, might be submitted to as part of the evils of war. Such a rise might be beneficial if wages were not raised by enforcing general economies. But when the rise in prices is universal, and the workers see (or say) that the first and biggest share is taken by the sellers of the things—whether makers or distributors—they clamour for their own fair share. The stronger the Trade Union the greater and the quicker is the rise in wages. Only after a long period of hope deferred does the rise extend to the weaker classes—weaker, that is to say, economically—the soldiers and sailors, the old-age pensioners, and the like. The widows and children who depend on the insurances made by the lifelong efforts of fathers and husbands instead of any compensation, suffer further loss by the fall in the capital value when the trust funds are realised.

The worst of it is that those of the working classes who get most of the bonuses are also the most dis-

contented. They ask for more long before the weaker members have got any share at all.

Rising prices due to inflation move in a vicious circle of increasing evils—increasing inequalities of sacrifice and increasing inequalities of unearned increments. Inflation is one of the worst forms of indirect taxation. Such are the commonplaces of economic theory confirmed by the financial history of every country. (See Part II., Chap. XLII., p. 458.)

Not only is the rise in prices the root cause of industrial unrest through overpayments and underpayments, but it brings other evils in its train more alarming to the Chancellor of the Exchequer and the great financial interests. There is, in particular, the growth of the adverse balance of indebtedness to foreign countries. Hitherto, we have struggled along by the export of securities—the fruits of real savings and enterprise—and by borrowing abroad at high rates of interest.

The warning of Sir R. M. Kindersley—the Director of War Savings—can no longer be disregarded: "These sales" (*i.e.*, of American securities) "are now practically at an end and we are brought face to face with our own shortcomings in regard to economy. The only sound method of financing war is from savings of expenditure on unnecessary goods and services by the individuals of the nation. The raising of money by any other means must of necessity lead to inflation of the currency."

The seriousness of the foreign trade position is now made more clear by the publication of the full returns. Up to last July most of the expenditure on Governmental account had been omitted. By the latest returns (August, 1917) the adverse balance works out for the year at the rate of about £556,000,000 as compared with £120,000,000 in normal peace times. Lord Rhondda has stated recently that for

ourselves and our Allies we shall have to purchase this coming year from America £250,000,000 worth of food.

Let us not be deceived by the unlimited resources of the United States. It is only ten years since the United States passed through a severe crisis which was the culmination of a period of prosperity (and inflation) far less in degree, and far less artificial in kind, than that of the present War. It is only three years since we were boasting of the unlimited resources of the British Empire. These resources are still unlimited from the standpoint of economic geography, but not from the standpoint of meeting an unlimited adverse balance of trade.

* * * * * *

These prefatory considerations may serve to explain why so much of the present book is occupied with questions connected with prices.

The book is divided into two parts. In Part I. are discussed some of the most difficult questions regarding inflation, *e.g.*, the meanings of the terms (Chap. IV.) and the statistical aspects (Chap. V.). The chapter on John Law (VI.) and that on the Napoleonic war period (X.) are intended to give historical support to the treatment of the present-day problem of inflation. The chapter on Indian Currency and Finance (III.) was included at first on account of the importance of the development of the gold-exchange standard, of which it is the leading example. The recent rise in the price of silver to 55 pence per ounce (September, 1917), and the proposal to replace the rupee by small notes, make the problem of Indian currency one of the most difficult and pressing with which the Government has to deal.*

In Part I. are also chapters dealing with some of the more general questions of economic policy.

* Within a month silver had again fallen to 42 pence.

Herr Naumann's famous book on Central Europe is examined (Chap. VIII), and an account is given of the tardy recognition by Germany of the greatest of her economic prophets, Friedrich List. The chapter on Trade after the War (IX.) has for the leading idea that the difficulties of Britain will arise more from the distribution than from the production of wealth.

There will be great disturbances in the old relations of labour and capital. During the War organised labour has found the threat of a strike (even though that strike was illegal) sufficient to enforce any demand, and capital was able to give increasing money wages because the prices of products were constantly rising through the inflation. But when prices begin to fall, how are the demands of labour to be met even for the permanence of the War bonuses? How is the State to provide the funds for all the social demands of labour, for the new houses, for the education of the children to higher ages—the very children who are now earning more than their fathers did in peace-time—and for the fulfilment of all the other dreams of after the War? The conscription of wealth will receive new interpretation and new encouragement.

There will also be a great disturbance in our traditional policy of foreign trade. There can be little doubt that the national sentiment of this country will not admit the restoration of pre-War relations until we are well assured that the repentance of Germany for the breaking up of the laws of nations and of the civilisation of centuries is not merely a regret for failure, but a return to common humanity. The duration and intensity of the economic boycott —even if we also lose by it—will depend on the evidences of the reality of the repentance.

Part II. is made up of a series of papers—extending over the first three years of the War—which I was

privileged to publish in the *Scotsman*. During a period when complaints were common of the suppression of the real freedom of the Press, I valued highly the unfettered hospitality of the columns of a leading journal. In return I tried to the best of my ability to apply throughout the test of patriotic duty. Many of the papers were re-written five or six times in the search for the right combination of judicial fairness with practical emphasis. In these papers the main object was to point out the consequences of the policy actually adopted. The dangers foretold of the neglect of well-tried economic principles have been only too fully realised. The only hope for any real change in economic policy is the realisation of the errors in the past.

In the actual conduct of the War we have acknowledged and amended great mistakes: witness the Dardanelles and Mesopotamia. In diplomacy also we erred, repented, and reformed. In both war and diplomacy we can now look back on three years of striving with satisfaction at the broad results. We have surpassed Germany in military power, and we have won over to our side the greater part of the world.

But in regard to our economic and financial policy no mistakes are admitted. We speak with the complacency of a heathenish Turk of war prices and war extravagance and *backsheesh* as if they had been inevitable.

Granted, that from a balancing of various causes some rise in prices was probable and some extravagance unavoidable, it is foolish to say that none of the causes are under human control, and that we must go on in the way we have begun.

In economic affairs everything turns on degree. By insensible degrees we pass from laziness to over-fatigue, from prodigality to penuriousness, from dull routine to wild speculation—in the whole sphere

of economic activity, as in most of the concerns of life, we have to steer between the too much and the too little.

Once on a time we were told that sickness in Mesopotamia was inevitable and bloodshed in the Dardanelles. Granted, but what we wanted to know was—How much of the bloodshed and sickness might have been avoided? How could the evils already incurred be remedied?

The mistakes in our financial policy have arisen because, instead of following any settled principles, we have practised a careless opportunism. Deluded by glowing estimates of the money value of the British Empire, we have neglected not only economic principles, but elementary rules of sound business.

Any satisfaction that might be felt in the accuracy of the forecast in these papers is overwhelmed by the fear that even now the warning from the past will not be heeded.

There is no sign of any real check on our reckless extravagance. To get one's bit of war bonus, not to bear one's bit of war burden, is the great object. The war bonus has spread like an ill weed over every field of the nation's activity; over the great fields and the little fields—always excepting the fields under military discipline.

In a war for national existence the rule ought to have been that for every kind of service required the State should pay less than in peace-time—the difference being put down to patriotism. When we relied, as at first we did, on the voluntary system, an appeal should have been made to patriotism for the provision of the materials of war as it was made for the provision of the lives. Why should the best of our young men be encouraged to enlist at a beggarly rate of pay and those left behind be allowed to take advantage of the depleted labour market to

get extravagant wages even for war work behind the lines?

When the voluntary system was replaced by conscription for the Army, and the supply of labour was still more contracted, why was the labour left behind allowed to get higher and higher pay? Why should millions be put under the most severe military discipline and other millions be bribed not to strike? There is no escape from the logical conclusion that the compulsion of life includes morally all the lesser industrial compulsions. Hitherto avoidance of industrial compulsion in this country has only led to gross extravagance—in itself a great national danger, although (thanks to the intervention of the United States) not so glaring and fateful as the anarchisms of Russia. Let us beware lest we have to invent an English word for *Sovietism*.

Capital in all its forms has had its bonuses and its anarchic freedom no less than labour. In fact, the wage bonuses were justified by their receivers chiefly for two reasons—the rise in profits and the consequent rise (so they say) of the cost of living. It is true historically (as often pointed out in the following pages) that in any inflation of prices as a rule capital gains at the expense of labour. "If only labour knew," labour itself has most to gain from a general fall in prices.

Fortunately, in the course of the War capital has been placed more and more under control. Excess profits have been taxed, and profiteering has been penalised. But with financial diseases prevention is also better than cure. The excess profits are calculated from a liberal estimate of the pre-War rate. To leave the sources of revenue unimpaired—whether of capital or labour—is no doubt the wisest maxim of finance. But to keep capital unimpaired is one thing—to keep up the pre-War rate of net profit is another. To give a War bonus is still another.

In spite of the assurance of the Chancellor of the Exchequer on the eve of the issue of the last great War Loan that never again would the British Government offer such favourable terms, a new issue of bonds is now being made (October, 1917), unlimited in amount, with bonuses of a more attractive kind. According to one calculator, the letter of Mr. Bonar Law's promise is strictly kept because the yield to the new bonds is actually 1*d*. per cent. below the yield to the last loan—but even this calculator admits there are other attractions, and presumably they have some monetary value. Other calculators make the terms of the present issue less favourable to the State. From the beginning of the war our public loans have been marred by complicated and expensive War bonuses. The cumulative effect has been to greatly raise the rate of interest paid by the British Government. Not only was a higher rate paid than was necessary or desirable, but the pernicious bonus was thrown in of the right of conversion into any higher rate.* Other Governments have followed the example. Even the United States, which began well, seems in danger of following our unfortunate lead—which, by the way, was only justified by its promoters by the supposed need for attracting foreign money.

The strange thing is that at the beginning of the War the Government took the very wise precaution of controlling both speculation and the issue of new capital—and yet, having made for itself a buyer's monopoly of loanable capital, never made the least use of it.†

* See on the Policy of Compulsory Borrowing, Part II., Chaps. XXXII., XXXVII., XXXI., etc.

† "There is no getting away from the fact that speculation in the Stock Exchange is increasing every week. The gambling—for it scarcely deserves any other name—is fostered largely by the same buyers, who for months past have propped the prop of Stock Exchange markets all round, namely, the provinces, particularly those where large money is being made in connection with war work of one kind or another. . . .

At the end of the War these high rates paid on the enormous public debts may endanger the security of property. A low rate of interest would have been a kind of cheap insurance.

To summarise:—The root evil of our financial policy has been the extravagant payments made by the State for all the services required for the War, whether of capital or labour—always excepting the labour of the actual fighting. The extravagance has only been made possible by inflation. The fruits of the evil are the waste of national resources, the increase in the inequities of distribution, and, worst of all, a degradation of the soul of the nation.

We entered this War, not with the hope of economic gain, but with the certainty of economic loss to the people of this generation as a whole. Justice and liberty at the beginning of the War were not names, but things worth fighting for. In the course of the War these high aims have been obscured by the pursuit of gain. The greatest national effort ever shown by this country has been the creation of a national army surpassing in military power that of Germany. The worst disgrace ever inscribed in our annals would be far surpassed if in the end this mighty effort and this unequalled sacrifice of our best lives were rendered vain by the misuse and the corrupting influence of that very money power

"Although there is a new National War Loan before the public to-day speculation is going on with increasing vigour."—*Economist*, 13th October, 1917. It is explained that one stimulus to the speculation is the desire to avoid the excess profits tax. In a letter (June, 1916) to Mr. McKenna as Chancellor of Exchequer, I suggested that in making any kind of investment at the same time a *pro rata* amount of some kind of war loan should be taken compulsorily. The rates might be varied indefinitely both qualitatively and quantitatively. With compulsion all round—when incidentally the conscripted small man loses not only his liberty but his business—why should the makers of war profits not be guided in the way of duty? Instead they are privileged to put in Treasury Bills at high rates of interest all the money they think they may require at short notice, and they can gamble with the remainder instead of lending to the State.

on which at the beginning of the War we most relied to outlast the enemy.

I am indebted to the editors and proprietors of the *Quarterly Review*, the *Economic Journal*, the *Journal of the Royal Statistical Society*, the *Scottish Historical Review*, and the *Annalist* (New York) for the previous publication of the materials of Part I., and to the *Scotsman* for Part II. Miss M. T. Rankin, M.A., at present acting as my assistant in the University, has kindly looked over all the proofs and made the Index.

J. S. NICHOLSON.

UNIVERSITY OF EDINBURGH,
October, 1917.

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PART I

WAR FINANCE

CHAPTER I

PRICES BEFORE THE WAR AND THE QUANTITY THEORY OF MONEY *

HISTORICAL INTRODUCTION

[AFTER the Franco-German War a great fall in prices occurred (1873–96). According to Sauerbeck's index number (average prices 1867–77 = 100) the level in 1873 was 111, and had fallen in 1896 to 61. The fall had been more or less continuous, with occasional upward movements (*e.g.*, 1879–80 and 1887–89), and the minimum was reached in 1896.

By 1907 the index number had risen to 80, and in 1913 to 86, but for about a year before the war there was a fall to 82. In less than three years of war, March, 1917, the index number rose to 168.

These very great changes ought to throw light on the causes affecting general prices. The following essay (written in 1912) deals mainly with the pre-war rise in prices after 1896, but great light is thrown on this rise by a preliminary study of the preceding fall in prices (1873–96).

Of this very remarkable fall in prices—practically to one-half of the former level—various explanations were given at the time, and were much discussed in the great bi-metallic controversy.

The causes then assigned for this fall may be divided into two main groups: (1) Those connected with commodities;

* First published in the *Quarterly Review*, October, 1912. The Historical Introduction written September, 1917.

(2) monetary causes connected with the precious metals, currency and credit.

In every great change of prices of historical importance—*e.g.*, in the transition from the mediæval to the modern period in the sixteenth century—the controversy as to causes is marked by a similar division. Attention is first called to commodity, and later to monetary, causes. This order of inquiry is quite natural, because any general rise of prices is observed first of all in its particular manifestations. Each particular price is always affected also by its own particular influences of demand and supply. In the case of any particular fall in price the first cause usually assigned is over-abundance of the commodity. As the fall in prices is observed to become more and more general it is ascribed to general over-production. Next in popularity to over-production as a cause of low prices (on the commodity side) is the fall in the elements of cost of production, including freights. These two causes are often combined. After 1873 it was observed that there were great developments of production in new countries, and these excessive supplies were dumped into Europe by improved transport. The revolution in transport in the last quarter of the nineteenth century, according to Dr. Marshall, was more far-reaching than the celebrated industrial revolution of the end of the eighteenth.

Those who objected to over-production and improvements as the main causes of the fall (1873–96) contended that the course of industrial progress had been more or less continuous from the thirteenth century onwards, and that progress had been marked both in periods of rising and of falling prices.* Accordingly they sought for the principal causes of the great fall in prices in monetary changes. In particular they pointed to the demonetisation of silver by Germany (with the substitution of gold) and to the falling off in the production of gold.

In this argument the appeal was generally made to the

* Nicholson's "Principles of Political Economy," bk. iv., chap. iii., § 7, vol. ii., p. 65.

quantity theory of money in a very simple form. The supply of gold had fallen and the demand increased. Therefore its value had risen. A rise in the value of gold means an increase in its purchasing power. This again means a general fall in prices. What could be more simple?

This explanation of the fall in prices seemed to be confirmed when in 1896 the reaction set in. Improvements in production and transport still continued, but prices rose instead of falling. On the other hand, there was a great increase in the supplies of gold in South Africa, North America, and other places. With the increase in gold there was also a great expansion of credit and representative money. Again the quantity theory was applied and seemed to fit the facts.

Corresponding to this practical controversy on the general movements in prices there had arisen a theoretical controversy on the quantity theory itself. In its simplest form, in which it is supposed that general prices move upwards and downwards exactly in proportion to the increase or decrease in the quantity (and rapidity of circulation) of money, it was observed that the theory was only tenable under simple conditions which were far removed from the actual.

As was shown in my "Treatise on Money" (first published in 1889), the simple quantity theory is only true in what I called a hypothetical market which was utterly unlike our modern markets. If, then, the quantity theory was still to be used for the explanation of the actual course of prices it must be in a modified or developed form. In this developed form all the various causes affecting general movements of prices must be subsumed, *e.g.*, the volume of trade, the extension of markets, and improvements in the supplies of commodities on the one side, and on the other side the supply of gold and of the various forms of representative money and credit.

The quantity theory of money developed in this way gives a basis of reconciliation to the conflicting explanations resting on commodities and money respectively. Both sets

of causes must be taken into account. Even in its simplest form the supply of money must always be taken with the demand for it as represented, for example, by the volume of trade. The exchange value of money, like all other values, must depend on demand and supply.

But what is the supply of money? What is the demand for it? And what is the nature of the equilibrium established between the two?

Each of these questions on examination is found to present great difficulties. Under the supply of money are we to include only gold, or are all those things to be included which in fact perform monetary functions? In particular, are cheques to be included in the quantity of money when we are applying the quantity theory?

Similar difficulties arise in the interpretation of demand. Are we to look only to the mass of commodities and the volume of trade? Do not the payment of wages, the payment for stock exchange securities, and other payments involve a demand for money?

The difficulties in this developed quantity theory led certain economists to its abandonment as a worn-out or uselessly complex set of hypotheses—like the cycles and epicycles of the old astronomy. This view was represented in the elaborate work of Professor J. Laurence Laughlin on the "Principles of Money" (1903).

The importance of the development of the credit forms of money was specially shown by Mr. Hartley Withers in his "Meaning of Money" (1909). Mr. Withers himself (following Bagehot) duly emphasised the importance of the gold basis. But the structure of credit superimposed seemed so large that most readers began to think the magnitude of the foundations was of little importance. A certain amount of gold was supposed to be necessary to meet the seasonal demands for internal purposes and to meet occasional foreign demands, but it was implied that there was no assignable proportion between the quantity of gold money and the level of prices (say) in England.

The rehabilitation of the quantity theory as applied to

gold was undertaken by Professor Irving Fisher in his work on the "Purchasing Power of Money" (1911). Here the leading idea was that other forms of representative money, notably bank deposits, were proportioned to the quantity of gold held by the banks. The proportion varied in different countries, and in the same country at different times, but given the necessary statistics the proportion could be ascertained. It was assumed that with every increase of gold held by the banks there was a determinate increase in the representative money. The total volume of money, coin and credit compared with the volume of trade determined the level of prices in the particular country concerned.

The fundamental importance of gold in the determination of world prices was emphasised by Sir David Barbour, the well-known authority on the theory of bi-metallism and on the practical application of the quantity theory to Indian currency.

In the development of the quantity theory on the lines of Professor Fisher fundamental difficulties are found in the relation of national prices to international or world prices. These difficulties became apparent both on the side of theory and of practice in the development of the gold-exchange standard. This system is noticed at the end of the present essay, but is more fully considered later on (Chap. III., p. 47).

To bring this short survey up to date I may add that the ideas at the root of the gold-exchange standard in Europe have been well explained by Mr. J. M. Keynes in the introduction to his book on "Indian Currency and Finance" (1913). A complete history is given in Professor Kemmerer's "Modern Currency Reforms" (1917).]

§ 1. Practical Importance of the Question

The recent rise in prices, especially in the articles that enter into the consumption of the masses of the people, has been so widespread and accompanied by such symptoms of social unrest that it has aroused the interest not only of economists and statisticians, but of the general politician and the general reader. What are the causes of the rise? How much longer will it continue? What are the remedies for the evils? These are questions being asked on all sides. Some of the consequences of a general rise in prices are obvious, and none the less serious and difficult to adjust because they are plain to view. Even in this age of legislation the greater part of all the business of the world is carried on by means of voluntary contracts; and these contracts involve the element of time, and are expressed in terms of money. If, then, in the course of time the "meaning of money" changes, the real meaning of the contracts also changes, unless such a change was contemplated and allowed for. Apart from definite legal contracts there are still, all the world over, numbers of agreements and customs involving money payments that are only capable of gradual and unequal change. The modern theory of wages asserts that in the case of any definite vendible product wages are paid out of the price of the product; and various methods are adopted in practice, by sliding scales and boards of conciliation and the like, to make wages respond to movements in the prices of the products. But wages are only one element in the cost of production; and the equitable relation of wages to prices is always difficult of determination, even if the parties are agreed on the principles to be applied.

§ 2. Wages and Prices

The difficulty of adjustment is all the greater when the rise in prices is not a rise in the relative prices of particular commodities, but is more or less general. Any general rise in prices must affect directly or indirectly all the factors of production as well as labour. The difficulty in the

readjustment of wages, and the comparative immobility of labour as compared with capital in general, cause the wages of labour, considered as the price of labour, to lag behind the upward movement of prices. This result, which is probable in theory, has been abundantly confirmed by experience. Nearly every country has, at some time or other, suffered from a general rise in its prices, caused by the depreciation of its currency, whether metallic or paper, and whether the depreciation is due to the act of the Government or to the cumulative effect of natural causes. And it has been observed in practically all cases that money wages rise much more slowly than the articles on which the wages are spent. The general consequence is that, so far, the economic condition of the labouring classes is adversely affected as compared with that of owners and employers of capital. The relative prosperity of capital with rising prices is shown by booming trade, and the relative depression of labour is shown by strikes. The truth of the reasoning as regards rising prices is confirmed by taking the converse case of a fall. The Commission on the Depression of Trade (Final Report, 1886), and that on Gold and Silver (Final Report 1888), found that, with the general fall in prices which marked the depression, wages had not fallen, and in consequence that the relative economic position of labour had improved; while the indirect effects of the depression of capital did not seriously affect the great mass of the workers.

§ 3. Rate of Interest and Prices

The recent rise in general prices has been associated with a rise in the rate of interest. But in this case the causal connection is not so easy to trace. With booming trade and greater demand for capital, with new issues of shares of all sorts of industrial undertakings competing for new accumulations, and with the spending powers of the richer classes increasing, the demand for capital is likely to rise faster than the supply. The natural consequence is a rise in the rate of interest. But there can be little doubt that the recent rise

in the rate of interest is to be ascribed largely to the general increase of security all the world over. Capital is now sent into places and employments which were formerly considered too dangerous by the mass of ordinary investors; they had found too often that high interest meant bad security. But in these days it has been discovered that relatively high interest can be obtained with proper distribution in new fields on practically as good security as low interest in the older fields. And, if regard is had not only to the yields of interest, but to stability in the capital value, the security of the older kinds of investments, with their low interest, seems less than that of the new with the high rate. As a natural consequence, capital has been diverted from the older modes of investment to the new; and the yield of the older securities has arisen with the fall in the capital value, as in the notorious case of Consols. How much of the fall in the price of Consols (or, what is the same thing, the rise in the yield) is due to the general extension of security, and how much to the rise in general prices, is a problem so difficult that most financial authorities leave out, in their enumeration of the causes of the fall in Consols, any consideration of the rise in general prices. But, if the rise in prices is the cause of the rise in the rate of interest, it is so far a cause of the fall in Consols. As it happens, people who take a very mild concern in changes in the cost of living, and would not feel appreciably a rise in the cost of bread and butter of 20 or even 100 per cent., are specially concerned with any movements in the rate of interest; for movements in the rate of interest affect all kinds of investments, and affect them in different ways.

§ 4. A Common Explanation of the Rise is found in the Quantity Theory of Money in its Simple Form

The position, then, is this: whether we look to social unrest and labour troubles, or to the gains of investors, or to the necessities of Governments in the way of borrowings, the economic question of perhaps greatest importance at the present time is the rise in prices and the associated (if not

consequent) rise in the rate of interest. To provide remedies for the social unrest and to reap the harvest of movements in securities (so far as they depend on the rise in prices), it is necessary to discover the causes; and this brings us to the "quantity theory" of money. The most common explanation of the rise in prices is the increase in the supplies of gold from the mines; and the way in which the increase in gold raises prices is supposed to be given by the "quantity theory" of money.

J. S. Mill, who more than anyone gave popular authority to the theories of Ricardo, wrote in the middle of the nineteenth century ("Pol. Ec." iii., 19): "That an increase in the quantity of money raises prices, and a diminution lowers them, is the most elementary proposition in the theory of currency, and without it we should have no key to any of the others." In its simplest form, carefully guarded by hypotheses, which, however, lay down conditions for the most part the reverse of those that prevail in the actual world, this proposition is indeed elementary. It may be made as simple as the proposition that if in a game you increase the number of counters you diminish proportionately the value of each. In its simplest form, also, the rise in prices consequent on an increase in the supply of money is supposed to be *exactly* proportioned to the increase in the quantity; or, put otherwise, the value (or the purchasing power) of each piece of money falls in exact proportion with the increase of supply. This exact fall in value as supply increases is, as Mill says, true of no other commodity; or, in modern phrase, the effect on value of the increase of the supply of other things will depend on the elasticity of the demand.

The quantity theory in its simple form has been associated with other propositions equally simple under similarly simple conditions, *e.g.*, that money is merely a medium of exchange; that all exchange is ultimately barter; and that it makes no real difference to the economic forces by which wealth is produced and distributed whether the range of general prices is high or low. In the long run or ultimately, it is said, whatever the movement in prices through the rise

or fall in the quantity of money, everything (including labour and capital) will find its proper price-level. By the aid of these and similar assumptions the quantity theory may be reduced to a harmless and uninteresting truism.

§ 5. Difficulties of this Simple Theory

But, as soon as we apply the quantity theory to practical conditions and get rid of the hypothetical safeguards, the simplicity vanishes. At the end of the chapter in which he sets forth the quantity theory, Mill, after giving some of the most important and obvious qualifications, remarks (*op. cit.* p. 22):

> "The sequel of our investigation will point out many other qualifications with which the proposition must be received, that the value of the circulating medium depends on the demand and supply, and is in the inverse ratio of the quantity; qualifications which, under a complex system of credit like that existing in England, render the proposition an extremely incorrect expression of the fact."

If the proposition was extremely incorrect as applied to England seventy years ago, what are we to expect when the theory is applied to the determination of prices in England at the present time, and to the still more complex problem of the world prices of the great staples of international trade?

§ 6. Historical Tests of Theory

At first sight it is true that recent monetary history seems to show that, roughly, the quantity theory is true in the case of an increase or diminution in the supply of gold. It is commonly said that general prices rose after the discoveries in the 'fifties in Australia and California; that they fell with the falling-off in production in the 'seventies; while in the first years of the new century, with a great increase in the supplies of gold, we have the rise that is now attracting so much attention. On closer examination this verfication of the theory does not seem so satisfactory. The estimated annual production of gold during the twenty five years 1851–75 was £25,000,000, as compared with an annual

production of £24,500,000 for the twenty years 1876 to 1895. The former period was a period of high prices, varying, according to the usual estimates, from twenty to thirty per cent. above the level of 1845–50; and the culminating point in the rise was about 1875, although the supplies of gold had already begun to fall off a little. In the next period (1876–95) there was a very great fall in prices (measured by the same index numbers), and the lowest point was reached about 1895. After 1895, for the ten years 1896–1905, the annual production of gold rose to £58,100,000, and in the next five years to £84,800,000; but the response in prices was so much retarded that people began to ask what had become of the quantity theory. Now that the rise in prices has become more marked, the popular idea is beginning to prevail that the quantity theory has again been confirmed. Tables of index numbers and of the estimated annual world's production of gold are not easy to read, and the selection of periods and averages is always suspected; but, when the figures are translated into curves,* there can be no difficulty in comparing the general trend of prices from the beginning of the nineteenth century and the general trend of the production of gold; and the comparison shows that for relatively long periods there may be no conformity even in the general trend of a rise or fall.

§ 7. Deeper Examination of the Theory

Moreover, deeper examination of the quantity theory reveals such a number of qualifications that any close correspondence of price movements with the annual production cannot be expected. The quantity theory in the simple form is always guarded by the expression "other things being the same"; but even in that very simple form, and with that assumption, the theory does not refer to the annual production of gold, but to the total mass in use for monetary purposes. Only part of the annual production

* See Chart of Wholesale Prices and World's Gold Production in W. T. Layton's useful "Introduction to the Study of Prices."

is made into money; and, compared with the total mass in existence, the annual addition is always relatively small. Again, even in the simplest statement, the volume of trade is supposed to remain the same; or (in other words) if the increased gold has to do more work, then the rise in prices may be neutralised. If the expression "volume of trade" is to be taken as equivalent to "the work to be done by the gold," its meaning must be extended to cover all the transactions for which gold is used; and it would be more correct to say the "volume of exchanges." Fairly correct estimates may be made of the volume of international trade between the principal countries, but similar accuracy is not obtainable for the internal trades of the respective countries, which in volume are much greater. It is said, for example, by Professor Irving Fisher (*op. cit.*, p. 485) that the foreign trade of the United States is less than one per cent. of the total trade of that country.*

If we were to consider the most obvious marks of the increase in "the work of gold" since the beginning of the nineteenth century—*e.g.*, the growth of population not only in new countries but also in Europe, the immense improvements in the means of communication, and with this the increase in trade and the rise in the consuming powers of the masses of the people—we should naturally suppose that an enormous increase in gold would be required even to sustain the same level of prices. And if gold were used for actual transactions always in the same proportion; if for a given value of exchanges the same amount of gold was required; and if also there had been no increase in the use of substitutes for gold, as by the development of branch banks and the extended use of cheques, then we should expect, in spite of the increase in gold during the last hundred years, a very great fall in prices. Under no other conditions could the gold suffice to do the work.

* A great understatement. In a controversy on this point with Professor B. M. Anderson, Professor Fisher admitted that eight per cent. was a not unreasonable estimate (*New York Annalist*, March 6, 1916).

§ 8. Rapidity of Circulation

It must be remembered that in the statement of the quantity theory in its simple form it is only true that the level of prices varies exactly with the increase or decrease of the money in circulation if, as Mill observes, (1) the rapidity of circulation is the same, and if (2) money passes from hand to hand at every transaction, credit in any of its shapes being unknown. If, in effecting a certain amount of transactions, on the average every piece of money is used ten times, the level of prices will be the same as if ten times as much money were used, each piece being only used once. This is what is meant by the rapidity of circulation. And with improvements in communication and in organisation of markets the rapidity of circulation is likely to increase very much. We can get approximate figures for the total mass of gold used for monetary purposes in the world, and form some idea of the additions made from year to year, but we cannot get even rough figures for estimating the rapidity of circulation of all this gold spread over all the gold-using world.

§ 9. Credit

But the difficulties of rapidity of circulation are as nothing compared with the allowance to be made when we introduce into the quantity theory the condition (at first omitted) of the influence of credit in all its shapes. As regards wholesale transactions, all but a mere fraction are now made solely by some form of credit, and not by gold passing from hand to hand. Even in international trade, gold only passes from country to country to meet an occasional adverse trade-balance; and the passage of gold in general depends much more on the state of the money markets and of the markets for securities in the respective countries than on the trade transactions. That is to say, the great bulk of international trade is carried on by means of credit substitutes for gold, *e.g.*, bills of exchange. And it is important to notice, when we are considering the effects of credit-substitutes on the level of prices, that the index-numbers

most in use refer to wholesale transactions, and chiefly to articles that bulk largely in international trade. It would seem, then, that, if the quantity theory is to apply to wholesale prices, it leaves out of account in the first statement the most important of all the conditions of actual commerce, namely, the use of credit instruments. It seems something like calculating the depth of water in a harbour by the rainfall and the inflow of the river, and taking no account of the flow of the tides. But it is old learning that the value of any working hypothesis depends on the proportional importance of the elements rejected to that of the elements retained. It is very easy to avoid contradictions with a sufficiency of hypothesis, or to prove anything from hypothetical bases, "other things being the same."

What, then, becomes of the quantity theory when we take account of this condition at first supposed absent, namely, that the bulk of wholesale transactions is not effected by the money in circulation, passing from hand to hand, but by means of credit? If the credit-substitutes act on prices as much as a corresponding amount of gold, then it is plain that the variations in the annual production of gold are of little importance compared with the changes in the production of "representative" or credit money. Since 1896 the total increase in the world's gold (for all purposes) has been calculated as £1,000,000,000. In the United States alone the deposits in banks operated on by cheques have increased by at least double that amount. The United States is only one country, and bank deposits are only one form of credit. It would be superfluous to show in detail that in modern developed countries, value for value, the wholesale transactions effected by the direct passing of gold are inconsiderable compared with those effected by credit. In his book on the "Meaning of Money," in which the treatment is as felicitous as the title, Mr. Withers states (in a chapter with the significant heading "The Manufacture of Money") that "the money of modern English commerce and finance is the cheque; and the credit dealt in in the London money market is the right

to draw a cheque." But the importance of the influence of credit on prices is not a discovery of this century, as is shown by Mill's chapter on the subject ("Principles of Political Economy," book iii., chap. xii.), which might still be read with advantage by the latest writers on the quantity theory.

§ 10. Gold and Prices. Professor Laughlin's Abandonment of Quantity Theory

In view of the enormous increase in "manufactured" money as compared with natural gold, can we say that there is any connection between the recent increase in the output of gold and the general rise in prices? If there is a connection, what is its nature? How does the new gold affect prices? By what actual processes, for example, does the gold from the Transvaal raise the price of living to English coal miners? It is quite clear that the quantity theory in its simple form is not applicable, simply because the most important conditions are not present. The new gold does not "pass from hand to hand in effecting a certain amount of transactions, credit in all its forms being unknown"; indeed, exactly the opposite is the case. If, then, the amount of gold is still of great, even of supreme importance in the determination of price-levels, it must be so by indirect influences.

The difficulty of the subject is shown in the works of two representative American writers. Professor Laughlin, in his "Principles of Money," frankly confesses that he has been forced to abandon the quantity theory; indeed, the main argument of his book is directed against that theory with all the zeal of the convert against his old belief. It is easy for the supporters of the old theory to reply that Professor Laughlin has not put in the proper quantities and qualities of hypotheses; that he has forgotten the condition "other things remaining the same," the elimination of credit, and all the other safeguards. Such a reply is, however, only formally or logically relevant. The real difficulty is: What about the quantity theory if other things are *not*

the same, and especially if we take account of credit? Professor Laughlin's own solution is analogous to that propounded by the late Lord Farrer in the days of the bimetallic controversy, and is once more effectively disposed of by Sir David Barbour in his chapter on "The relation between Money, Credit and Prices" (*op. cit.*, cap. vii.).

§ II. Professor Irving Fisher's Rehabilitation

The more recent book by Professor Irving Fisher is definitely designed to rehabilitate the old theory, and not only to restore it to life, but to dress it out in the latest scientific fashions. Both books are interesting, though both are altogether too long and too diffuse for clearness in the presentation of monetary theories. Professor Fisher may plead in excuse, first, that he wished to make an inductive proof, and that induction means a mass of facts; and, secondly, that he wishes to reach the practical man, and therefore it was necessary to put in pictures of balances and bags, and reservoirs and pipes. But the practical man is not a child, and this appearance of simplicity is misleading. The writer has also provided for the mathematical economist, partly in the text and partly in the modern fashion in a mathematical appendix; but the practical man is not in general a mathematical economist. The main conclusion of Professor Fisher's book, put in ordinary language, is that the most important factor in the recent rise in prices is the increase of gold. And he is so much impressed by this cause and its consequences that he makes a proposal for the gradual adoption by the world in general of a modification of the "gold-exchange" standard; which would mean the abandonment of the gold standard in its present form, and the adoption of something like the method now in use in India; for example, the sovereign—like the rupee—would receive an artificial value.

Sir David Barbour, to whom more than to anyone the change of standard in India was due, has published most opportunely a book on "The Standard of Value." This book, unlike the two mentioned above, is extremely short,

and in some parts perhaps too short for the complexity of the argument. It is also designed specially for the practical man, and, as giving an account of the currency changes in India, and their causes and effects, will always be a work of the first importance to the student of monetary history. As showing the importance of the quantity theory, from the practical point of view, it was in firm reliance on that theory that Sir David Barbour proceeded (so he tells us) to close the Indian mints to silver, and to establish partially or indirectly the gold-standard or in reality the "gold-exchange" standard. Sir David implies rather than states the theory, and the theory is apparently taken in a very simple form; but incidentally he refers to the "more scientific" form of the theory given by Professor Fisher, and apparently looks with approval to the ultimate adoption of some variation of the gold-exchange standard by the world at large.

§ 12. Critique of this Rehabilitation

It is doubtful, however, if this more "scientific" form will stand the test of verification; and the inductive proof offered seems to be of the nature of illustrations guarded by hypotheses; if, indeed, the fundamental position does not involve a *petitio principii*. The proof of the extended quantity theory is worked out mainly in the case of the United States. Estimates are given of the amounts of "money" in use and the changes in these amounts and the corresponding changes in prices. Of the correspondence there can be no doubt, any more than there can be any doubt of the proposition that in any market the quantity bought must equal the quantity sold. The monetary transactions of the United States must be effected by means of "money"; and, if the money is made up of coins and cheques, there must be a correspondence between the volume of the monetary transactions and the volume of the money. If account is also taken of the efficiency of the money or the rapidity of circulation we have an identical proposition. The amount of "money" used multiplied by the average of the times each unit is used must equal the volume of monetary transactions; and with

a rise in prices more money must be used for monetary transactions.*

But the real difficulties lie deeper. What we want to know in connection with the new gold supplies is precisely how they bring about the rise in prices in the United States and other countries. It helps us very little to be told that the quantity of money has increased if the greater part of the increase is not in gold but in credit. Accordingly Professor Fisher asserts that there is a definite proportion between the amount of deposits (operated on by cheque) and the amount of gold. Gold, he says, is used for certain purposes and cheques for others; and the prevailing custom keeps the proportion very definite. This is a partial statement of a very old truth as regards different forms of convertible currency, namely, that if the forms are in reality (as they profess to be) convertible, the proportions will vary simply according to the convenience of people, as, for example, the use in Scotland of one-pound notes and sovereigns. If there is any difficulty in obtaining any one form of currency for some special purpose, this form will bear a premium. Cases are on record in which bank-notes have been at a premium compared with the actual coin which they are supposed to represent and which they profess to pay on demand.

§ 13. Difficulty of Exact Connection of Gold and Credit

It may be taken for granted that "under the same conditions" the proportion of cheques to coins in monetary transactions will remain constant; and it may be of interest to find out why the proportion varies under different conditions and in different places—to compare, for example, the use of cheques in England and in France. The next step in Professor Fisher's argument is to use this definite proportion between cheques and coin so as to extend the quantity theory to gold together with the superstructure

* *Cf.* Sir William J. Ashley in "Statistics and the Theory of Money," in the *Economic Review*, April, 1912.

of credit based on gold. And the argument really amounts to saying that, if you increase the amount of gold in a country, *ipso facto* you must increase the amount of credit; and, therefore, although most monetary transactions are in forms of credit, the rise in prices is proportioned to the increase in the gold. In other words, the new gold expands credit, especially bank-deposits, in the same proportion; and the deposits and gold together raise the prices by the simple quantity theory of money.

That all credit ultimately rests on a gold basis—that is to say, in the gold-standard countries—has long been admitted. Bagehot, in his "Lombard Street," showed how the credit superstructure, and with that the solvency of England, rested on the reserve of gold in the Bank of England; and his argument has been brought up to date by Mr. Withers. From this point of view the real limits to the expansion of prices under credit are found in the fact that all these forms of credit are convertible into gold if required. In ordinary times the conversion is not asked for; in times of crisis, with a foreign drain of gold, the conversion may be asked for to such an extent as to threaten the ultimate reserve. It has long been recognised that, besides the possible foreign drain, there may be, with an inflation of credit-prices, an internal drain for wages and other cash transactions. With a rise in money incomes there is an increased demand for gold for use in the arts and the like. These three drains—foreign, internal, and industrial—impose very definite limits on the expansion of credit, as is recognised in all the monetary text-books. But it is quite a different thing to say that, if we increase the amount of gold in the banks, credit will be increased in the same proportion. The strengthening of the foundations does not of itself raise the height of the superstructure, even if the superstructure is credit.

§ 14. Difficulty of International Price-levels

One flaw in Professor Fisher's argument is his failure to appreciate the interaction of international price-levels. He

admits the interaction only in the simplest form of the quantity theory. He seems to suppose that in every country the level of prices is determined by the quantity of money (cash and deposits) in that country, and that the levels of the various countries are adjusted to the general level by the flow of gold, the gold as it flows expanding or contracting credit, and so moving prices. But this simple argument gives us no idea how much or how little an increase in the world's gold will raise prices. We never get beyond the main position of Ricardo, that the gold will be so distributed that the trade of the world will be carried on as before; or, to adopt a later setting of the same truth, that relative prices will be so adjusted that the relative values as determined by economic forces will remain the same. Like all other abstract propositions in political economy, this only expresses a tendency liable to be counteracted by disturbing causes. The proposition will remain true, or this tendency will be revealed, other things being the same, whatever the rise in prices happens to be. In some way or other the gold will be distributed; and, if there is a general rise in prices in consequence, in the course of time the work and the pleasures of the world will be measured on a new basis. But besides the quantity of gold there are a number of causes of the first importance affecting general prices; and for an indefinite period it is possible that gold may be increasing and prices not rising, or even falling.

§ 15. Proposed New Gold-exchange Standard

When we come to apply Professor Fisher's argument to the problem that is at present exciting so much interest, we have no means of telling how much of the rise is due to the new gold, or how much further the rise may go. He himself, indeed, seems to anticipate so great a rise in prices that the nations of the world ought to agree to substitute for the gold standard an artificial gold-exchange standard, so that the sovereign, for example, would no longer correspond to the gold of which it is made, but to some idea of purchasing power. On this plan, if prices rise as measured

by the index numbers, then gold is to be withdrawn, and with the contraction of the currency by the simple quantity theory prices are to come down; while, if prices fall, gold is to be let loose and prices are to go up. It is not necessary to go into the working of the process of the manipulation of the gold, but the basis of the whole scheme is the contraction and expansion of the gold currency so as to operate against movements in prices. "Therefore the currency will be contracted *and general prices will fall* until no more gold is called for, or until there is declared a new official price for gold" (Fisher, *op. cit.*, p. 343).

§ 16. Proposal Criticised

The difficulty of this plan may be seen by looking to the recent movements of prices in England. By the latest figures of the *Economist*,* compared with the basis of 1901–5, prices rose in 1911 some 17 per cent.; and this year there has been a further rise of some 8 per cent. In July, 1912, the index number was just 25 per cent. above the basis of 1901–5. If the sovereign was to have retained the same purchasing power, its scarcity value must have been gradually enhanced (by contraction of the currency) in the same proportion as the rise of prices indicated by the index numbers. The sovereign at this time, if the plan had been perfectly successful, would be one-quarter more valuable than the corresponding amount of gold of which it is made; or, roughly, the mint price of gold, instead of being a little under £4, would be a little under £3. But currency can only obtain a scarcity value by being made scarce; and the effects of giving a scarcity value to the sovereign on the London money market would altogether outweigh any advantage to be obtained from greater stability in the purchasing power of the sovereign. England might perhaps look with equanimity on the adoption of this index number gold standard by other countries, just as it would have done if they had adopted bimetallism. The old tabular standard

* The *Economist*, September, 1912.

seems much more simple, and would be, in theory, much more effective. All that is needed is to pass a law that, if the index number rises as recently, say, 25 per cent., then all creditors are to get £125 instead of £100, and nominal wages are to rise in the same proportion. It is, however, generally agreed that the practical difficulties of the tabular standard are so great that it can be applied only in a very limited number of cases.

§ 17. Further Criticism

As regards this new gold-exchange standard based on index numbers, it has not yet passed the preliminary theoretical examination. It is true that the gold-exchange standard of India has been successful in the attainment of the object desired, namely, a fixed parity of exchange of the rupee with gold, under normal conditions. Sir David Barbour has given in his new book a clear and valuable account of the way in which this has been effected. It is not easy to specify to which class of currency the new rupee belongs; it has resemblances with the limping bimetallism of France, with ordinary token coins, and with bank-notes of which the convertibility is partially suspended or otherwise impeded. However we class it, so long as the principle of limitation is observed and an adequate reserve of gold is available, the parity of the rupee can no doubt be maintained. But to ensure the convertibility of various forms of currency at fixed ratios is a problem totally different from the attainment of stability in the purchasing power of the standard on which these various currencies are based. The former problem has been solved in different ways from the earliest times; there are many examples of currencies at fixed ratios, and ratios different from the commodity-values of the substances of which they are made. But there are no cases on record in which any standard has attained stability of purchasing power under changing conditions; and such a standard is generally held to be unattainable. The working of a gold-exchange standard based on index numbers is totally different from the working of such a

standard as that of India. Professor Fisher does not realise this distinction.

> "It is a little anomalous" (he says) "that these gold-exchange standard countries now have a power to regulate their price-level which is not possessed by the gold-standard countries themselves. The latter are, by their present system, kept absolutely at the mercy of the accidents of gold-mining and metallurgy, while the former can keep or change the par of exchange with gold countries at will" (*op. cit.*, p. 340).

Now, rupee prices in India during the last ten or twelve years have risen about double, though the parity with gold has been maintained. We should like to know by what methods Sir David Barbour would have proceeded if he had been asked to ensure the stability of the rupee in general purchasing power.

§ 18. Need for Further Inquiry

Before any serious manipulation of the world's currencies can be expected with the view of attaining greater stability of purchasing power, the causes which under modern conditions bring about changes in general prices must be much better understood and much more accurately measured. The revised version of the quantity theory gives us no more assistance in connecting the new gold supplies with the recent rise in prices than was given by the theory in its older forms. In some respects the revised version is retrograde. The relations of credit to gold on the one side and to general prices on the other, and the distinctions between inconvertible and convertible currencies, are not so clearly realised by Professor Fisher as by Mill and Bagehot, not to mention later writers. He tries to apply the quantity theory in a simple form to actual problems, but his main results are either hypothetical or illustrative of hypotheses. One thing, however, his book has shown, and that is the necessity of a much deeper and broader investigation of the causes that affect general prices, and therefore the purchasing power of money; and, if the International Commission of which he

is the advocate is appointed, we may expect valuable results. In the meantime, however, although it has been approved by the President of the United States, the appointment has been delayed, apparently for political reasons. It is said that the opponents of the tariff in the United States are unwilling to admit that the rise in the cost of living in that country has any other serious cause; and they think the admission that, perhaps, the new gold has something to do with it might abate the popular resentment against the tariff.

§ 19. Possible Fall in Prices

It is quite possible that, before the International Commission is appointed, the rise in prices may have met its reaction.* Even if the supplies of gold do not fall off, there are other factors of at least equal importance to be taken account of. The value of money (*i.e.*, in the sense of its purchasing power) depends, like other values, on demand and supply. The price level must be so adjusted by the play of demand and supply that the quantity of "money" offered at that level will be equal to the quantity demanded. Stated in this most general form, the theory is difficult to grasp; and the difficulties are increased when we consider the various elements that enter into both the supply of "money" and the demand for "money." The annual production of gold is only one of the elements affecting the supply of "money." The recent conference of bankers in Germany has shown that the expansion of credit money has been pushed to the extreme. The American crisis of 1907 is not yet forgotten. To judge by past history, the rapid development of new countries seems likely to lead eventually to a period of over-production and a consequent fall in prices. The demands of India and possibly of China must be considered. That there is some connection between the quantity of gold available for monetary uses and the level of prices may still be considered as plain a truth as that there

* As observed in the introduction to this essay, prices actually fell in 1913–14 (before the war).

is some connection between seasonal temperatures and the apparent movements of the sun. But the meteorologists have recently confessed in public their inability to forecast the weather even for a season in advance, and the currency prophets would do well to imitate their caution.

CHAPTER II

THE ABANDONMENT OF THE GOLD STANDARD

Prefatory Note

[This essay was originally written for the December, 1914, number of the *Quarterly Review* and was first published in April, 1915. The justice of the diagnosis of the nature and the causes of the abandonment of the gold standard has been fully confirmed by subsequent events. So also has the forecast of the coming troubles. The essence of the abandonment is found in the restrictions on the convertibility of the various forms of credit. The immediate and extensive adoption of inconvertibility (in varying degrees) is accounted for by the changes in monetary policy consequent on the demonetisation of silver by Germany after the Franco-German War. The "scramble for gold" (Goschen) was intensified by the great fall in its production. The transition to the gold standard by the nations formerly bimetallic and by the silver-standard countries was imperfect, and was accompanied by all kinds of "economies" in the use of gold. The so-called economies were for the most part restrictions on convertibility. The convertibility that had always been fully interpreted by England was restricted by these other countries to foreign payments. The result was that throughout the greater part of the world some form of the *gold-exchange* standard was adopted in place of the gold standard in the traditional British interpretation. In normal times the difference was not observed, since for internal purposes convertibility was only required within narrow limits. But before the outbreak of war it was generally recognised that London was the only free market for gold, that is to say, the only centre in which the various

forms of credit supposed to rest on gold could actually be converted into gold without any impediment or extra payment. It is true that the great national banks held large reserves of gold—far larger than the Bank of England—but they were not held for actual use.

Before the war the idea had come to be generally accepted that for internal purposes gold was a useless luxury and that paper was in every way much better. The ideal was a gold standard without gold. Even as regards foreign payments economies in the use of gold had been carried to an extreme. Reserves were held abroad or various provisions were made for obtaining money at short notice in foreign parts. The general consequence of this great economy of gold, coupled with a great increase in production after 1896, was an undue expansion of credit as shown specially in the United States in 1907 and in Germany just before the war. On the monetary side this economy of gold, coupled with the increase in production, gave great apparent strength to the national banks. The real strength of the world monetary system was undermined by imperfect convertibility. The consequence was that as soon as war broke out the gold standard was abandoned by all the belligerents to a greater or less extent. In England the process of abandonment was gradual and disguised. The new currency notes for £1 and 10*s*. were nominally convertible into gold, but they were issued just like inconvertible notes without any definite legal limitations. The primary object of the present essay was to point out the consequences of this easy finance supported by paper money and the dangers of inflation and a rise in prices. No attention whatever seems to have been paid by our financial authorities to this possibility of internal inflation. All their efforts were directed from the beginning to preserving the stability of the foreign exchanges, especially with the United States. The interconnection between internal inflation and adverse foreign exchanges, which had been recognised as vital by the old masters (*e.g.*, Goschen), was entirely disregarded. At the end of the article it was pointed out that the rise in

prices due to inflation at home would increase the adverse balance of trade and make the adjustment of the foreign exchanges more difficult. For a long time the stability of exchange with the United States has been kept up by loans and sales of securities, but such procedure does not "correct" the exchanges in Goschen's sense, but simply pays the penalty.

It is now clear that our greatest labour troubles at home are connected with the rise in prices largely due to the easy finance of inflation, and the difficulties of our foreign payments have been intensified by the same cause.]

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§ 1. Extent and Nature of the Abandonment—Moratorium and Inconvertibility for Internal Payments

The Great War will be long remembered for other things besides the destruction of life and the reconstruction of the map of Europe. On the financial side the most notable event was the universal abandonment for the time being of the gold standard. The abandonment varied in extent, was effected by different devices in different countries, and was described in the kind of language that is familiar from the bulletins of defeated armies; it was not an abandonment at all, but only a temporary retirement under the guidance of the higher financial command.

The two principal forms assumed by the abandonment were the moratorium and inconvertibility. The two forms are in essence the same. Inconvertibility is generally applied to bank-notes; it means that the bankers are authorised to refuse to meet their promises to pay in gold on demand. A moratorium means that all debtors (not specially excluded) are authorised to postpone the fulfilment of their monetary obligations. Germany adopted at once the method of inconvertibility, and prided itself on not being obliged to adopt the moratorium. But inconvertible notes were issued on such terms and to such an extent that a moratorium was not needed. France adopted both methods The United

Kingdom adopted openly the method of moratorium and in a disguised manner the method of inconvertibility. English people will long remember the beginnings of the Great War when some of the London banks refused to give gold for Bank of England notes and people were forced (or delighted) to receive postal orders as legal tender. They will long remember also the advent of the new sin of hoarding gold and the new virtue of turning it out of the pockets into the banks. With the war the whole duty of the private man as regards gold was declared to be total abstinence; the proper place for gold (so it was preached) was a bank; and the proper business of the bank was to hoard it. For a time the banks were commanded by the Treasury not to pay out gold.

§ 2. As regards Foreign Payments

The abandonment of the gold standard by the respective nations each within its own borders was still more marked as regards foreign payments. England was a large creditor; and failing other modes of remittance large sums of gold were due in London on the outbreak of the war. But the foreign debtors with one consent hoarded their gold. The essential idea of a banking reserve was lost sight of. A reserve is intended to meet an exceptional strain. In ordinary times it is useless; it is never drawn upon to any marked extent; there is always an apparent over-abundance. But on the outbreak of the war the great banks refused to part with gold, especially for foreign payments. Six months after the outbreak of the war the banks of France, Germany and Russia retained their enormous stocks of gold practically unaffected. Such a general abandonment of the gold standard could not have taken place unless the monetary evolution had long since been tending in that direction. A short historical survey seems the best way to explain both the nature and the extent of this abandonment and the promptitude with which it was effected.

§ 3. Historical Explanation. (*a*) Strain on Gold due to disuse of Silver as Standard after Franco-German War (1870–71)

Down to the conclusion of the Franco-German War of 1870–71, gold and silver were, generally speaking, on an equal footing as standard money. In India and the Far East silver was the sole standard and the principal metallic money. In some of the most important Western countries (*e.g.*, France and the countries forming the Latin Union and the United States) the double standard prevailed; gold and silver were legal tender to any extent at a ratio fixed by law, and the mints were equally open to both metals. In the United Kingdom gold was the standard, and silver was only used for token coins. So long as this state of things lasted, although there were no formal international agreements, practically a certain amount of silver all the world over would always command a certain amount of gold (within very narrow limits), so that for ordinary purposes and for banking and international trade the two metals were interchangeable to any extent.

This system, which *de facto* had great stability and great advantages, was upset by the action of Germany on the conclusion of the Franco-German War. This action of Germany was due, like all the main lines of her recent economic policy, to the imitation of Britain. Germany thought that British commercial supremacy and the predominant position of the London money market were largely due to the gold standard. Therefore Germany determined to have a gold standard, and set about what was called the demonetisation of silver. This action of Germany upset the balance of the two metals, and they were no longer interchangeable in the same way. A given amount of silver would not obtain the usual amount of gold but a less amount. Silver was depreciated, and the depreciation increased. The consequence was that other nations found it necessary or desirable to make gold the only standard. In order to do this they put the silver (which they held in large quantities

as standard money) in some kind of dependent relation to gold, the nature of the relation varying in the different countries.

§ 4. (*b*) Practical Difficulties in the Readjustment

This process of readjustment took a very long time; and during that time there was a continuous fall in prices and a great depression of trade, the fall of prices reaching its lowest depth in 1896. The difficulties in the general adoption of the single gold standard were greatly increased by the falling-off in the supply of gold. In course of time, however, practically all the nations of the world put themselves on the gold basis, and all the great financial and commercial transactions of the world came to be conducted on this standard. The actual monetary contracts were no doubt expressed in terms of the various national currencies, but all of these were ostensibly linked up with the gold standard. As it happened, since 1896 this universal adoption of the gold standard was greatly facilitated by the largely increased production from the mines. Before the outbreak of the present war it seemed as if the new gold was sufficient not only to provide for this universal adoption of the gold standard, but also to cause a general rise in prices. Certainly the common opinion in financial circles is that, just as the fall in prices before 1896 was due to a decrease in the gold supplies, so after that date the rise in prices has been due to their increase.

§ 5. (*c*) Hazy Ideas on Nature of Monetary Standard

Unfortunately, however, during the process of getting rid of silver as an alternative standard and making gold the sole standard, there grew up very hazy ideas on the nature and the uses of a monetary standard. These hazy ideas were made the basis of important changes in financial practice. The ultimate effect was that, even before the outbreak of the war, gold had in reality become less effective as a monetary standard than it was in the days when its

dominion was supposed to be shared equally with silver. The reason is that in various forms and to various degrees the pernicious principle has been adopted of deferred or suspended or delocalised or denationalised convertibility. Ostensibly, with the adoption of the gold standard all monetary obligations were to be met in gold; but practically all sorts of expedients have been invented to "economise" (as it is euphemistically called) the use of gold.

§ 6. Laxity of New Interpretation

The degree of the change in opinion and practice may be realised by reference to the bimetallic controversy. Then the great argument of the gold-standard purists was that in the natural course of things silver would depreciate. Therefore it was said that, if debtors (governmental or private) could discharge their debts in silver, they would do so and the British gold creditors would suffer. Bankers in particular were horrified at the idea that promises to pay in gold could be made good by payments in silver, or in currency or credit based on silver. The stability of the London money market, and with it the stability of British trade, was supposed to be dependent on the maintenance of the gold standard in the strictest and most absolute form. The adoption of the gold standard by Germany confirmed this view.

§ 7. Practical Examples of Change in Standard. France—India: Beginnings of Gold-Exchange Standard

This strict maintenance before the present war of the gold standard in the United Kingdom, where it had been effectively established since the conclusion of the Napoleonic wars, was an easy matter; it was only necessary to observe the old maxim—"quieta non movere." But in other countries, where silver had been standard money, the real establishment of gold as the sole standard was a matter of great difficulty. In France, for example, silver was still full legal tender, though the mintage was restricted; and in that country the double standard had given way to what was

known as the limping standard (*étalon boiteux*). In India, although the dominant metallic money is still silver, silver is not the standard, nor on the other hand has the gold standard been effectively adopted, but only that modification of it that in these latter days has come to be called the gold-exchange standard. Its opponents call it the gold standard without gold. The essence of this standard is that, by the limitation of the coinage of rupees and by other devices, fifteen silver rupees in India are interchangeable with a gold sovereign in London (within narrow limits). This is no doubt, in normal times, a convenient arrangement for the Governments of India and of England, though whether it is advantageous to the people of India is another question. The present point is that, although India is supposed to have a gold standard, its principal metallic money is only imperfectly convertible into gold. It is a case of suspended or deferred convertibility.

The plan adopted by India in 1893 with the closure of the mints to silver was not new. The Report of the Committee on which action was taken after a comprehensive survey of monetary systems concludes :

> "It would thus appear that it has been found possible to introduce a gold standard without a gold circulation ; without a large stock of gold currency ; and even without legal convertibility of an existing silver currency into gold."

This method of imperfect convertibility * had been adopted in different forms by the principal countries of Europe. There was an appearance of monetary strength in the masses of gold held in the central banks, but any exceptional demand for this gold, especially for foreign remittance, was met by making a special charge, or in some cases by actual limitation. The gold was in effect hoarded by the central banks, and provision for foreign remittances was met by foreign credits in various forms.

* *Cf.* "Money and Monetary Problems" (Essay on the Indian Currency Experiment), by the present writer ; J. M. Keynes, "Indian Currency and Finance," chap. ii.

§ 8. Imperfect Convertibility under New System and its Consequences compared with the Old

In normal times this imperfect convertibility of credit into gold was not even noticed and certainly caused no apparent difficulties. In normal times most monetary transactions are concluded without the actual passing of gold. But the real meaning of effective absolute immediate convertibility (no single word can convey the full meaning of the old system) was not simply that people could always get as much gold as they found convenient (*e.g.*, for making ornaments or for payments abroad), but that very real effective limitations were imposed on the undue expansion of credit.

The simplest credit substitute for gold is a bank-note, which in essence is a promise to pay on demand the metallic money that it is supposed to represent. Notes based on gold are strictly convertible only so long as the demand for conversion can be met under any conditions within the range of practical possibility, as shown by the financial experience of nations over long periods. The demand for conversion into gold in ordinary times is one thing; it is a demand that is only exercised within very narrow and customary limits. But the demand for conversion in extraordinary times is quite another thing, and it is only in extraordinary times that the real stability of a monetary system is tested.

It was the necessity for being ready for exceptional strain that induced nations to adopt very stringent measures as regards the issues of bank-notes. The issues have been limited in all sorts of ways, and special provisions have been made for securing an adequate reserve against any emergency. Curiously enough, the legal restrictions on the issues of notes by the Bank of England are more severe than those of any other great Bank. After a certain amount has been issued (now some £18,000,000), for every other note an equal amount of gold must be kept in the Issue Department. The consequence was that, in the week before the outbreak of

war, against an issue of notes of £55,121,405 the Bank held gold coin and bullion to the extent of £36,671,405. After six months of war the Bank of England held in the last week of January gold coin and bullion in the Issue Department £68,352,305 against an issue of notes £86,802,605. There was also a sum of £813,512 of gold and silver coin in the Banking Department. It would seem from the figures of the Issue Department that the Bank of England notes were secured to a ridiculous point of safety, namely, with about 80 per cent. of gold.

But it is most important to observe that all the other forms of credit, just like bank-notes, are ostensibly convertible into gold on demand. Even if the date of payment is deferred, as in bills of exchange, by the method of discounting, the present value is convertible into gold on demand. For the week quoted above the account of the Banking Department of the Bank of England shows a reserve against liabilities of 32 per cent. as against a proportion of 51 per cent. a year before. As shown by Sir H. Inglis Palgrave, in his standard work on the Bank Rate and the Money Market, it is not the absolute amount of the reserve but the proportion that counts. The great argument of Bagehot's "Lombard Street" is that the Bank of England ought to keep a far larger reserve in proportion than other banks, mainly owing to the uncertainty as regards the magnitude and the times of foreign demands. This argument has been strengthened by the course of events since that foundational work was published.

§ 9. London before War kept up Strict Convertibility

Before the outbreak of the war London was more than ever the centre of the financial world. The fact has been repeatedly forced on public notice since the war began, but it is doubtful if its importance has been adequately realised by the public. So long as every promise to pay means in the last resort a power given to the holder of the promise to get gold from his bank, his bank is obliged to have the command of gold. If his bank finds it convenient,

instead of keeping gold, to have a credit with the Bank of England, then the Bank of England, "the bankers' bank," must keep a stock of gold equal to any possible demands not only of this particular banker, but of all the holders of similar promises to pay gold. In this way the reserve of the Bank of England imposes, or ought to impose, stringent limits on the expansion of credit. The essence of the system by which London became the central money market of the world was the immediate convertibility of all credits into gold. In other countries, especially after the depreciation of silver, this convertibility of credit into gold became imperfect, which is only another way of saying that credit was unduly expanded.

§ 10. CRISIS OF 1907 IN UNITED STATES.

The effects of this laxity in the interpretation of convertibility into gold was shown in the great crisis in the United States in the autumn of 1907. There had been an undue inflation of credit and prices—over-banking and over-trading. When the demand for real convertibility set in, it could not be met. For a time the United States had really an inconvertible currency consisting mainly of cheques that could not be cashed. The effects of this crisis were world-wide. Everywhere there was a great contraction of credit for the time being, and a great fall in the prices of securities. It might have been expected that the crisis of 1907 would have given the banking world a lesson, but the only immediate effect in the country of origin seems to have been the evolution of a new scheme for emergency currency in case of another crisis. To save trouble the emergency notes were at once printed and stored ready for use. Such was the foresight of the United States; and it is now made a matter of complaint that this country was not equally provident. But this is anticipating the course of events.

§ 11. THE GOLDEN CALF THEORY OF GOLD RESERVES BEFORE THE WAR

The general position of the commercial and financial world before the outbreak of the war may be expressed in

two propositions. Firstly, gold had been nominally adopted as the universal standard of value. In the countries in which silver coins were still unlimited legal tender (*e.g.*, France, India, etc.), they were supposed to be in the position of bank-notes convertible into gold—they were "bank-notes printed on silver." Secondly, this nominal adoption of the gold standard had only been imperfectly realised in practice, because the different kinds of representative money—not only the silver and the bank-notes, but all the various forms of bankers' credits—were only imperfectly convertible into gold. In normal times—within customary narrow limits—they were convertible into gold; but on the slightest strain some kind of difficulty was put in the way of getting the gold immediately. The only exception was London. London was acknowledged to be the only free market for gold—the only market that was likely to be open in times of stress. It is no doubt quite true that in the other great banking centres the greatest respect was shown to gold. The other central banks piled up far larger reserves than the Bank of England. But, for all the good it did, the greater part of this gold might as well have been molten into great golden calves, to be worshipped by the customers of the banks.

§ 12. Imperfect Convertibility of Credit

The principal effect of this system of imperfect convertibility was that credit was unduly extended, and that the limit on its expansion, properly imposed by effective convertibility into gold under even exceptional circumstances, was broken down by the use of all kinds of "soft" substitutes—the time and place of the actual convertibility being apparently a matter of no moment so long as the promise to pay was not definitely repudiated.

This economy in the use of gold in practice was supported by a corresponding development of theory. As generally happens in economics, the theory was invented to explain and justify the practice. We were told that paper was much more convenient than gold for internal currency,

and that the actual circulation of gold was wasteful. It would be quite sufficient to keep a reserve in bullion, and the bullion itself would only be required for an occasional balance in international payments. If a country held enough gold for this occasional emergency, then the rest of its gold could be left to fructify in Egypt or South America instead of being subjected to useless wear and tear in the pockets of the people. Even as regards these fitful international payments, every effort was made to minimise the useless transmission of gold.

The natural consequence of this economy of gold was that the outbreak of the greatest war in history found the financial world with inflated credit and inflated prices, and with an ordinary commercial crisis like that of 1907 looming in the near future. The only difference was that in some cases the emergency currency was ready; and, if in other cases the emergency measures to be taken had not been regularised by far-seeing legislation, the minds of all men were fully prepared for the suspension of any inconvenient laws and the substitution of practical measures (and paper) worthy of the occasion.

§ 13. The War and the Low Bank of England Rate.

The consequence of this development of easy finance and the substitution of a system of great elasticity for the old cast-iron system was, as shown by the most extraordinary results, almost too good to be true. All over the world, under the old system of credit, the Bank of England rate had been regarded as the best measure of the stability of the world's credit system. In the great crises of the nineteenth century the bank rate rose to 10 per cent., and in one year (1866) remained at 10 per cent. for ninety-six days and over 7 per cent. for other ninety-six days. This great crisis arose simply out of the failure of one great firm. But within a week of the declaration of war by England, August, 1914, the bank rate was reduced to 5 per cent., and at 5 per cent. it has remained up to the time of writing, although a kind of arithmetical deference was shown to old tradition

by the adoption of a 10 per cent. rate during a five days' Bank Holiday. It is remarkable that a year before, in the midst of profound peace, the bank rate had also been 5 per cent., so that it looked as if the Great War had had no real effect on the world's financial system. The newspapers were full of congratulations on the ease and the speed with which the crisis had been suppressed. The Chancellor of the Exchequer became the most popular man in the City. At the Lord Mayor's banquet it was announced that a peerage was to be conferred on the Governor of the Bank of England. All seemed for the best in the best possible of worlds.

§ 14. Other Signs not so Favourable

It is true that, even when we look only at the surface of things, the situation does not seem quite so cheerful as is suggested by the glut of money in the London money market. The Stock Exchange was closed to the end of the year; and the premier security, the old Consols, which used to be considered as good as gold and as the barometer of public credit, was unsaleable at an official minimum price too high to attract buyers, and higher (value for value) than the price of issue of the new War Loan. When, with the new year, the Stock Exchange was opened, it was under severe restrictions both as regards dealings in old securities and the creation of new. The Bankers' Clearing Returns show a reduction for January, 1915, of 21 per cent. compared with the first month of last year. It was remarked by the chairman at the annual meeting of one of the great joint stock banks that the primary object of a gold reserve was to inspire confidence, and that it must above all things be visible. But the Bank of England has put itself in line with the new theories on the gold standard by keeping an unknown part of its gold reserve in Canada, South Africa, Australia, and (it is supposed) other places. It is true that the Bank Act of 1844 has not been suspended, but the enormous issues of Treasury notes, against every

principle of that Act, render this technical abstention insignificant.

§ 15. "Short Period" and "Long Period" Effects of Easy Finance

It may be admitted, however, that the aggregate effect of the various measures taken by the Government in a sudden and unexampled emergency has been for the time very pleasing; but, in judging of the full effects of any economic disturbance, we must always distinguish between what economists call the "short period" and the "long period." With regard to the "short period," on the outbreak of war everyone expected a series of earthquakes accompanied by the fall of financial houses great and small. It appears, however, from a calculation in the *Times*, that the insolvencies in England from August to December were less in number and in magnitude than in the corresponding period for the year before; they were, indeed, below the average, and there was no failure of any particular importance. In the same way people expected a great increase in unemployment; and instead there has been a decrease, just as in insolvency, except in Lancashire no great industry seems to have been much afflicted, whilst many have attained unusual prosperity. It is true that exports have fallen off; but imports have almost reached the normal, and the ports are congested with undistributed cargoes. After six months of war there is apparently no real economic pressure so far as we are concerned, whilst we have the gratification of observing all the symptoms of increasing pressure in Germany. If these marvellous results and this astonishing contrast are to be ascribed to the financial measures adopted in England and Germany respectively, then the clamour of self-congratulation is at least pardonable, if excessive. But are they to be so ascribed? Is there not something of the simplicity of the *post hoc ergo propter hoc* in the conclusion? And are the "long period" effects likely to be equally satisfactory?

§ 16. The Restoration of the Foreign Exchanges by Governmental Guarantees of Bills on London

First of all, attention may be directed to the effects of the emergency measures on the foreign trade of the country. Unfortunately an adequate appreciation of this side of the question depends on understanding the working of the foreign exchanges, and this is a matter to which in this country very few people, even bankers, pay any regard in the ordinary course of their business. The ordinary man does not know even the meaning of the foreign exchanges. When he was told that the foreign exchanges were dislocated, he probably thought that it was part of the business of the navy to put them right. He never imagined that the proper remedy was for the Bank of England to give extended credit to certain London financial houses and in return to receive a guarantee from the Government against any ultimate loss. It was explained that the welfare of the nation and the continuance of our foreign trade were inseparably mixed up with the stability of these financial houses. The bill on London had come to be recognised as the world's international currency. In its essence the bill on London was a promise to pay gold on demand or something that would be as readily accepted. The actual gold was, in fact, seldom demanded, and the bill was not always payable on demand; but the essence of the system was that the bill was as much linked up with the gold standard as is a note of the Bank of England. The bill on London was made good most effectively for the time. How much eventually will be added to the national debt in consequence is looked on as negligible in the midst of the flood of the other governmental expenditure necessary for the war.

§ 17. Exaggerated View of the Immediate Benefits

In judging of this restoration of the foreign exchanges, two points ought to be borne in mind, one retrospective, the other prospective. The dislocation of the foreign exchanges was not due to any probability of a run on the

Bank of England in what is called a foreign drain of gold. On the contrary, the real difficulty was that other countries owed to London so much gold that they were unable, or thought they were unable, to pay. They thought they were unable to pay because they were afraid of the effect of appearing to lessen their gold reserves. They were all dominated by the golden-calf theory of banking reserves. The principal offender (be it said with all respect) was the United States of America. As the event showed, only time was necessary for the exchanges to be restored in the usual way; but, as time was of importance, the action of the Government was generally approved. The difficulty, however, of that action ought not to be exaggerated.

The prospective point is of more practical importance. Is the restoration likely to be enduring, or are the measures adopted in an emergency liable to have a set-back later on? To answer this question the measures must be considered which were taken, apparently not in the interests of foreign trade, but of home trade and industry.

§ 18. Continued Excessive Issues of So-called Emergency Currency Causes Inflation

Here it is difficult to understand on what principles, if any, the country was flooded by emergency currency. Notes for one pound and for ten shillings were issued as fast as possible, and at first were supposed to be intended to support the banks. The banks were to be allowed to borrow these notes from the Bank of England up to 20 per cent. of their liabilities. If the banks had acted on this privilege they could have borrowed and issued over two hundred millions of these notes, which, having regard to the banking system of this country, was an absurdly extravagant amount. Fortunately the banks scarcely made any use of the privilege. But long after the banking system of the country had settled down—and it was never much upset for internal purposes—the Government continued to issue millions of these notes. By the end of the year the amount had exceeded thirty-eight millions; up to January,

1915, every week had seen an increase. Besides this, postal orders were made legal tender and were issued free of charge; that is to say, they were exactly like bank-notes of small denomination, that could be issued by any private person who chose to give coin for them, and in general the coin was silver. They were convertible into any legal coin at the Bank of England. The Treasury notes proper were convertible into gold, but the provision for convertibility was practically non-effective. The notes were by the Act to be convertible at the Bank of England, but, in order to assist the Government and the Bank of England, the country banks were encouraged to use the notes as much as possible and to send any surplus gold to the Bank. An ominous foresight was shown even in the superscription of the Treasury notes; they bore no promise to pay in gold. In case of complete inconvertibility being adopted subsequently, they would be all ready and would not need to be reprinted. Even this flood of postal orders and Treasury notes does not complete the sum of the governmental assistance to the country in the way of providing "money," since in other ways there has been a great extension of bankers' credit, the chief form of modern money.

§ 19. The Rise in Prices ascribed to other Causes

That such and so great an inflation of currency and credit should raise prices, including the prices of food and other necessaries, seems never to have entered into the minds of anyone in authority. The Cabinet Committee appointed to inquire into the rise of prices issued a statement in which eleven points were put down for investigation, but the inflation of the currency was not even mentioned. The check to the issues of the notes from January is the only sign that this old way of paying new debts is not to be indefinitely continued. The worst of it is, as all experience shows, that a rise in prices due to currency causes is never detected until it is so marked and general that the

ordinary abuse of the speculator and the shippers and the railways and all the other brigands seems unequal to the situation.

§ 20. Inflation Increases the Adverse Balance of Trade.

There is, however, one way in which an inflation of prices is forced on the attention of the great financial authorities. If the rise in prices encourages imports and checks exports, then there will in time be a difficulty in meeting the foreign payments, and the foreign exchanges will again be dislocated in a way that the Government will find not so easy to correct. Germany has apparently already begun to feel this effect, which is of course so far a comfort to us, but it recalls the old proverb about the house of one's neighbour being on fire: "*proximus ardet Ucalegon.*"

CHAPTER III

INDIAN CURRENCY AND FINANCE IN RELATION TO THE GOLD-EXCHANGE STANDARD *

Prefatory Note

[As indicated above (p. 34), the Gold-Exchange Standard is one of the principal monetary developments of modern times. It is not, however, so new as is generally supposed. My old pupil, Professor Robert Leslie, has published in the *South African Journal of Science*, November, 1916, an interesting account of the adoption of the method in Cape Colony in 1825.

The best recent example of the gold-exchange standard is that of India. Since the closure of the Indian mints to private coinage of silver in 1893 Indian currency has been managed with the object of keeping up the gold exchange value of the rupee to sixteen pence. Before the war this parity was more than 30 per cent. above the metallic value of the rupee, and though it took some time to establish it survived the shock of the American crisis 1907–8. It is now more seriously threatened by the great rise in the price of silver. On 14th Sept., 1917, silver touched 51*d*. per oz. as compared with 26*d*. in August, 1914. As a consequence, it is proposed to issue notes for one rupee and two and two and a half rupees. If the rupee (in Mr. Harrison's phrase) is only a note printed on silver, why not print it on paper? In my opinion such a substitution of paper for silver is extremely injudicious and possibly even dangerous from the political stand-point.]

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* First published in the *Economic Journal*, June, 1914.

The reports by various commissions of inquiry appointed at various times by the British Government contain some of the most valuable materials for economic study in existence. The value to the economists is not diminished, even if the final conclusions of the reports may not be adopted. The Report of the Royal Commission on Indian Finance and Currency * is a very able document and, with the corresponding evidence, gives materials of the highest interest at the present time for the student of the principles of monetary theory and their practical illustrations in the most modern forms. A large part of the Report is substantially in accord with the treatment by Mr. J. M. Keynes in his recent book on Indian Currency and Finance, and the reader of either may be strongly recommended to read the other.

In my opinion, however, there are omissions both in the book and in the Report which are of the first importance in theory and in the future may be of vital importance in practice. The practical side of the issues I wish to raise is dealt with in Sir James Begbie's note of dissent, and I shall treat of the same difficulties with reference to the relative economic principles and former cases of practical importance.

This paper is mainly concerned with the ulterior and cumulative effects which seem probable if the present system, even as modified in the Report, is continued.

The admirable history of Indian currency since 1893 given in the general report shows at once that in all the various changes the dominant force, whether in initiation or modification, has been the stability of the foreign exchange value of the rupee in relation to gold. From the beginnings of the depreciation of silver after 1873 the Indian Government was troubled with the instability of the gold-exchange value of the rupee, and British trade with India was also troubled with it. One of the principal arguments of the bimetallists was that the fixity of the ratio of silver to gold would also fix the gold value of the rupee, with consequent general advantage to trade, to the investment of capital in India,

* "Final Report of the Royal Commission on Indian Finance and Currency." 1914. [Cd. 7236.] Price *9d.*

and to banking as well as to the Government. By 1893 the attainment of stability of exchange (or at least a check to a further fall) to the Indian Government seemed necessary, and to the British trader very desirable. The Indian mints were closed to the coinage of silver, and since 1898 the policy pursued has been successful in maintaining the normal gold value of the rupee at 1*s.* 4*d.*

The Report, in its final summary of conclusions, sec. 76 (p. 20), says that " the cardinal feature of the whole system is the absolute security for the convertibility into sterling of so much of the internal currency as may at any moment be required for the settlement of India's *external* obligations."

No one will dispute that this fixity of exchange is in itself advantageous and especially advantageous to the Indian Government. But the question arises: Does it follow, because the stability of the gold price of the rupee has been established for the purposes of foreign exchange, that therefore it may be taken for granted that all the other functions of good money are fulfilled by the rupee as so " managed " ?

What are the primary functions of a good system of money ? The first is to provide a *medium of exchange,* not mainly for foreign payments, but for the purposes of internal trade and industry. The first requisite from this point of view is that the money shall be universally accepted, hence the importance in the early stages of development of the *commodity* value of money. Even in the latest stages any difficulty in testing or any want of confidence at once so far limits the acceptability. We have numberless instances of imperfect acceptability in the incubation period of the depreciation or debasement of different forms of currency. In the extreme case of the depreciation of inconvertible notes the acceptability may vanish. Between this extreme of non-acceptability and the other extreme of instant universal acceptability there are infinite gradations, and we have an excellent example of the economic principle of continuity.

The question, then, is this: Is this artificial rupee as acceptable to the people of India as was the old rupee, which was of the same value as the metal of which it was composed ?

Have the masses of the people of India reached the stage at which the commodity value of the money is of no importance? The answer of Sir James Begbie is definitely to the contrary: ". . . the recent demands for gold in India show a loss of confidence on the part of the public in the token rupee. . . . The need for confidence to secure the exchange value of the rupee is recognised, but not the need for confidence in the currency in other respects." (Report: note by Sir James Begbie, p. 88, par. 5.)

The next requisite of a good medium of exchange is that it should be readily adapted to the demands of trade: the volume of the actual currency should be capable of automatic increase or decrease. Such automatic adjustment is most nearly attained when the principal currency is interchangeable at once with the corresponding metal. Such was the old system of the rupee under the silver standard. Such is the system of the currency of the United Kingdom as regards gold, notes, and cheques. But even in the United Kingdom there are occasionally difficulties. At one extreme, for example, as regards the small token coins, we hear sometimes of the scarcity of farthings. At the other extreme, before Goschen's Act for the gold recoinage (1890) the banks had begun to feel the difficulty of getting rid of the light-weight gold coin. The preliminary stages of depreciation had begun, and even in England the automatic adjustment of the gold coins was threatened.

In the case of India this point is best taken in connection with another of the principal functions of good money, namely, that it should provide a *store of value.* The earliest form of saving is in hoarding the precious metals. India, as regards a large part of its population, is still dominated by primitive ideas of hoarding. "The hoarding habit in India is no doubt a difficult problem. Its recent rapid development in increased demands for gold and the possibility of its further expansion make it a question of the highest importance." (Note by Sir James Begbie, Report, p. 89, par. 10.) Under the old system the metallic value of the rupee was the same as its nominal value. A native would hoard rupees

or turn his rupees into ornaments, as it suited his convenience. Under the present system, if a native hoards silver he does not know what the value may be later on in rupees. If he hoards gold he believes he will get the fixed amount of rupees. Therefore he prefers gold to silver. He also prefers it to token rupees. There is an alternative use for gold, and according to Gresham's law it is withdrawn from circulation and absorbed in hoards in preference to rupees. In the opinion of Sir James Begbie, this hoarded gold is not so readily released as was the silver formerly. The confidence in the rupee has been partly lost. "Statistics show this later reversion to hoarding on an extended scale is a retrograde movement."

It must be remembered that the rupee, like any other form of token money, can only be kept at a fixed value as regards gold by the use in some form of the principle of limitation.* For the first seven years after the closure of the mints to silver for private coinage there were practically no new issues. The deficiency was in part supplied by the release of rupees from hoards and by importation from outside. So long as these sources of supply were available, the principle of limitation did not have its full effect. In consequence the rupee failed to maintain the 1*s.* 4*d.* value, and fell at one time to 1*s.* 1*d.*† After stability had been attained in 1898, the needs of more currency, as shown by the difficulties of moving trade and the stringency of the Indian money markets, led to the issue of new rupees by the Government. Since 1900 these issues have been very largely increased, but not so as to threaten (except, perhaps, in the crisis years of 1907–8) the gold price of the rupee.

The point is that the amount of rupees coined depends partly on the demands for remittance in London, partly on the offer of gold in India to be converted into rupees, and

* This principle of limitation was clearly stated by Ricardo with important historical illustrations in his "Reply to Mr. Bosanquet's Observations on the Report of the Bullion Committee" (McCulloch's edition, p. 347).

† This possibility was foreseen by the present writer in an article entitled "The Indian Currency Experiment" in the *Contemporary Review*, September, 1893. Republished in "Money and Monetary Problems."

partly on the estimates of the Government as regards Indian requirements for trade or banking.

But the amount issued is not automatic, as under the old system. The vast volume of the Indian currency is now a "managed" currency.

The Report notices this objection that without gold in active circulation India's currency must remain a managed system, with the implication that a managed system is a bad system (sec. 66, p. 18). The passage may be quoted in full:

> "The ideal with which this managed system is contrasted seems to be the system of the United Kingdom, where fresh supplies of the only unlimited legal tender coins, the sovereign or half-sovereign, can be obtained by anyone who takes gold to the mint for coinage. In our opinion this contrast is of no value. There does not appear to us to be any essential difference between the power to import sovereigns at will and the power to have gold coined into sovereigns in India. The *only* [the italics are mine] point of the criticism that India's currency system is managed in a sense that is not true of the currency of the United Kingdom lies in the fact that the rupee is a *token* passing at a value above its intrinsic value, and at the same time is unlimited legal tender. It is true that it is not practicable even to consider the limitation of the amount for which the rupee is legal tender. In this sense, therefore, the system must remain a *managed* one. But we demur altogether to the idea that because it is to this extent a managed system it must be a bad system. It is not, in fact, possible for the Government of India to *manipulate the currency for their own ends*, and they cannot add to the active circulation, *except in response to public demands*."

The difference between the power to have sovereigns coined and the power to import them is not always quite so negligible as is shown by the famous case of Australia after the discovery of gold (in the absence of a mint). The market price of gold in South Australia is said to have fallen to 45*s*., and in Victoria to 60*s*., as against the Mint price in London of £3 17*s*. 10*d*. But at present this side of the management is of comparatively small importance compared with the "*only* point of criticism" noticed immediately after. The rupee is a token of unlimited legal tender, and not only so, but, taking the country as a whole, it is the principal medium of exchange, as well as being in effect the standard of value.

Gold is used and notes are used to a certain extent, but the rupee is still king, though his monarchy is more limited than it was.

The answer of the Report to this objection is singularly meagre. We are told first that the Government cannot manipulate the currency for their own ends. But the basis of the whole system, as shown in the historical introduction, is that the Government adapts the system so as to secure stability of exchange for its own convenience. The mints were closed to raise and maintain the exchange, and the complex arrangements for keeping a reserve, and the nature and the *locale* of that reserve, have all been guided by the ends of the Government. So long as the rupee maintained its value in gold payable in London, the rest of its monetary functions were either not considered at all, or were supposed to follow, by some kind of pre-established harmony inherent in the gold-exchange standard.

Next, it is assumed in the Report that so long as the rupees are issued not for the immediate profits of the mintage, but in *response to public demands*, there can be no difficulty in the management. The central difficulty is that at any particular time the public demand may seem well founded and the new issue may seem desirable, but the method of new issues is only one side of the question of management. There remains the management of withdrawals or of contraction in case of need. If rupees in India could be converted into gold in India without any difficulty or postponement, then the contraction of the currency would be automatic. In fact, the rupee would be, like a bank-note, convertible immediately into gold. But the very essence of the gold-exchange standard is in showing "some degree of unwillingness to supply gold locally in exchange for the local currency, but a high degree of willingness to sell foreign exchange for payment in local currency at a certain maximum rate." (Keynes, *op. cit.*, p. 6.) This difficulty of the conversion of the local currency into gold makes the rupee correspond, so far, to an inconvertible, and not to a convertible, note. It is true it is not absolutely inconvertible, but, as already

observed, there are all degrees of inconvertibility. In the development of Scottish banking there were some interesting cases of deferred or suspended convertibility which helped to make Adam Smith a non-free trader in banking. In the case of India there may be a considerable cumulative increase in the circulation before the method of partial convertibility adopted comes into effective operation. In general the balance of trade is in favour of India, and so long as this favourable balance exists the volume of rupees can be increased.

In a very able critique of the Report by Mr. F. C. Harrison (*Quarterly Review*, April, 1914), which appeared after this paper was written, it is said: "At present there is no real distinction between the rupee and the note. Both are liabilities of the Government to be kept at a parity with gold. One is a note printed on silver, the other a note printed on paper." This identification of the rupee with a convertible note leads to curious consequences. In India the lowest denomination of the note is five rupees—why not one rupee? Why go to the expense of printing the one rupee note in silver? Why in most countries is the lowest denomination of note so high relatively to the highest tokens? The answer to these questions involves *inter alia* an answer to the old questions: Is an over issue of convertible notes possible? And is the danger specially great if the notes are of very low denomination?

As the result of prolonged controversy, it became clear that over issue might mean relatively to the reserve, or over issue so as to promote or aggravate an inflation of prices on account of the *de facto* suspended convertibility of small notes. What is the amount of the reserve held in India against the rupees actually in circulation, apart from what is supposed to be necessary to support the notes and the foreign exchange? In the proposal for a central bank, submitted by Mr. Keynes (Annexe to the Report, p. 69), it is laid down that only up to 40 per cent. of the gross circulation should be held in a fiduciary form without tax, the balance being held in cash (gold or *rupees*). Obviously, if the rupee is

itself a note printed on silver, it cannot form a reserve for the conversion of rupees, and if a corresponding proportion of gold is to be held against these notes printed on silver, that would mean over sixty million pounds of gold for this purpose (taking the circulation of rupees as 160 millions of crores [Mr. Harrison]). Mr. Harrison faces the difficulty, though he thinks 30 per cent. in gold against the notes (whether printed on silver or paper) would suffice, but he remarks: "The India Office has never appreciated the fundamental difference between holding gold and holding securities." In Mr. Keynes' scheme the fiduciary issues of notes may be increased up to 60 per cent. on the payment of a tax—but not beyond—but in the excessive issue of rupees there is actually a profit of most of the difference between tenpence and sixteen pence.

Again, the Government is not legally bound to give gold for rupees in India, though in practice it has made the offer in recent years, and in the case of recognised specific depreciation and the presentation of large quantities it could not do so. The suspension of the English Bank Charter Act does not mean that the notes become inconvertible, but simply that the fiduciary issues of the Bank may be increased beyond the cast-iron limit. The suspension of the offer of the Indian Government to give gold for rupees in India when asked for would make the rupees *de facto* inconvertible in the strict sense of the term.

At this point it is convenient to bring in another function of money, namely, as a standard measure of values. As already observed, in India as a whole the rupee is still king, and all prices are estimated in rupees, and not in gold. The ordinary native of India knows no more about the gold-exchange standard than the ordinary Englishman knows about the mint price of gold or the possible differences between the mint and the market price. If a monetary system is sound, this is the ignorance of the healthy man who knows nothing of the anatomy or physiology of his own body. It is a bad thing for a country when the masses of the people begin to feel that something is wrong with the currency.

As regards the possible effect of the gold-exchange standard on general prices in India, the Report seems to be absolutely silent. And yet it is precisely this aspect of the monetary standard that has lately attracted attention all the world over. Everywhere there is an outcry against the rise in the cost of living. The rise is complained of in all the countries with the gold standard. The gold standard is no security, as the last forty years have shown, against general movements of prices, down or up.

Since 1900 there has no doubt been a great rise in general prices in India, and if India had had in every respect precisely the same standard and currency as in this country, a rise of prices must have been expected.

But the question of importance is whether the present system in India (which is not that of the United Kingdom) is likely to aggravate the rise in prices.

As already shown, the rupee has only an imperfect or impeded convertibility. Accordingly, the connection of the rupee with general prices is best seen by taking the case of inconvertible notes. Such notes have been issued sometimes for a considerable period without any depreciation, but in most cases (owing to this very difficulty of management) depreciation, to a greater or less extent, has taken place eventually, and there is always the fear of depreciation.

It is important to distinguish between the *specific* depreciation of notes as regards gold, and their *general* depreciation as regards commodities. The premium on gold is not always the exact measure of the depreciation of the notes as regards commodities.* That is to say, the purchasing power of the notes *qua* commodities may be greater or less than is indicated by the depreciation as regards gold. There is no doubt a connection between the *specific* and the *general* depreciation, but sometimes the divergence is considerable.

In the same way, though the rupee remains at the par of the gold-exchange standard, its general purchasing power may have fallen. Prices in terms of the local currency will

* The general argument is too long for treatment here. *Cf.* Nicholson's "Principles of Political Economy," vol. ii., p. 128, bk. iii., chap. xv., sec. 4.

depend (other things being the same) on the quantity of that currency. If the quantity is only slowly increased (in proportion to the work to be done), the cumulative effect of new additions will be so much longer postponed. But if the means of contraction or withdrawal are inadequate; if the convertibility is only partial or suspended, then in time, if new additions are continued, the cumulative effect must operate. General rupee prices will rise, and after a certain point is reached this general depreciation may lead to specific depreciation, in spite of the large reserves held to support the foreign exchange (especially if a great part of these reserves is documentary and not in gold).

In such a country as India, with very imperfect credit and banking, and with an immense area and population, it is plain that additions to the currency operate more directly on prices than in modern Western countries. No doubt an increase in quantity will take longer to work out its general effect, and conversely any contraction such as will effect general prices will also take longer. Says Mr. Keynes: "So long as the rupee is worth 1*s.* 4*d.* in gold no merchant or manufacturer considers of what material it is made when he fixes the price of his product" (*op. cit.*, p. 12). True: but suppose that the method of keeping up this price of the rupee leads to a great and continuous increase in the quantity. The method may be quite successful, at any rate for a time, as regards the 1*s.* 4*d.*, but if the quantity of the rupee is increased general prices, so far, will rise.

In this connection a reference may be made to the period of the Bank Restriction in England (1797–1823), when the Bank of England was restricted from giving gold for its notes on demand. The principles of the case have been well brought out by Bagehot in his "Lombard Street." The essence of the history is simply this:—For the first ten years the notes, though inconvertible, remained undepreciated as regards gold. Apparently the directors had acted in the soundest manner. Yet, says Bagehot, when they came to give the reasons for their action they have become classical by their nonsense. They applied, it is true,

a principle of limitation that seems natural enough. They only made advances in terms of notes for the *bonâ fide demands of trade*, and at a high rate of discount. They thought in this way the demands for currency were fairly indicated, and that, therefore, there could be no depreciation. But they forgot the cumulative effect. None of the notes being withdrawn or sent abroad, in time the quantity became too great, prices rose, and, *inter alia*, the price of gold. Whether the rise was in both cases exactly the same is an old and interesting question, precisely that old question of the measure of depreciation.

In effect it would appear that the method of limitation now adopted as regards the issues of the token rupee is the same as that adopted by the Bank of England in the Restriction. So long as the rupees are issued only in response to a supposed real effective demand, it is thought that there can be no depreciation (see Report, p. 19). The specific depreciation as regards gold may be guarded against or provided for by the devices used for the maintenance of parity, but in the course of time the rupees in circulation will accumulate, and after a certain point a rise in price must follow. In the case of India, with its favourable balance of trade, the rise in prices must no doubt be considerable before the parity of the rupee will be affected for foreign exchange, but in the meantime India suffers from the beginnings of a general depreciation. And in the end, as already observed, even specific depreciation may take place, especially if the reserves held are in the main documentary and not actually in gold.

This paper began with the statement that the Report failed to give adequate consideration to certain aspects of Indian currency that in the course of time might prove to be of grave concern. In conclusion, the omissions and the possible evils may be briefly summarised.

The leading idea in the criticism offered was to refer to the primary functions of money. Owing to the necessary interconnection of these functions, a treatment of any one involves a reference to the rest.

As regards the function of money as a *medium of exchange*, the Report, following the practice of the Government of India for the last twenty years, considers the rupee mainly from the point of view of foreign exchange. It considers the means by which the stability of the gold-exchange value of the rupee may be safely and most economically secured. It seems to be taken for granted that if only this stability is maintained it makes no difference to the people of India if their principal metallic currency is token money. The opinion of the 1898 Committee that the gold standard should be gradually made effective by the use of more gold as currency is discarded; it is argued that to support the stability of foreign exchange the gold would be much more useful massed in some banking centre, the preference being given to London. The ready interchangeability of the coins with the corresponding metal within the country (which, under the old system, was so convenient) is passed over as of no importance.

The function of money as *a store of value* is emphasised in connection with the accumulation of gold to be used in case of need to support the gold-exchange value of the rupee, but the more primitive form of the *store of value* in the native hoarding is neglected. The native can no longer hoard silver; he has not the same confidence in the rupee as a token; therefore he hoards gold, and he is less willing to part with this gold when there is a difficulty placed in the way of getting it back. With regard to the function of money as a *standard measure of value* (including *deferred payments*), it seems to be taken for granted in the Report that if the rupee is only linked to gold for foreign exchange, its value or general purchasing power must conform to that of gold as determined by the world's markets and the world's banking. It seems to be thought that it can make no difference what the "intrinsic" value of the rupee may be. If, however, the rupee ought to be regarded as partaking of the nature of an inconvertible note, this simple relation will not hold good.

But so far as the rupee is like an inconvertible note, so

far it is subject to the same limitations or liable to the same dangers. In particular there is the danger (unless the volume is strictly limited) of a general rise in prices. If water flows into a reservoir in greater amount than to the extent of all the withdrawals, the level will rise, though, of course, it would rise more quickly if there were no means of withdrawal. As a matter of fact, there has already taken place in India a great rise in rupee prices. The extent and the nature and the causes of the rise are open to controversy, but, roughly, since 1900 the rise in prices seems to have been associated with the increase in the volume of the rupees. If the inflation of the rupee currency has already begun to operate, we may expect that in the near future the rise will be still more marked. This possibility is serious; already some of the highest authorities have given this rise in prices as one of the chief causes of Indian unrest. We know by theory, with abundant historical verification, that in a rise of prices due to inconvertible paper or any analogous cause the mercantile and trading classes gain at the expense of the masses. Even if the rise in prices is due to an increase of gold, until the period of transition is over the same rule seems to apply. In the case of gold, however, there are natural economic forces which in time must limit the monetary supply, and so far the level of prices, but in a managed currency such as the rupee these natural forces are absent or weakened. No one, for example, would melt down rupees to make ornaments, but gold coins are constantly so melted. Even the Government is not likely to contract the currency by melting down rupees, unless the evil of inflation has become intolerable. But after a certain point is reached in the inflation, the general depreciation in the purchasing power of the rupee must be followed by a specific depreciation as regards gold; and if this is the case, then the main object of the whole policy is defeated.

To prevent misapprehension, two supplementary observations may be made. The Report does, no doubt, pay considerable attention to possible development of banking and the use of bank-notes, and so far considers the medium

of exchange from the point of view of internal requirements. But when we are told that 90 per cent. of the Indian people cannot read, and when we know they are very poor, this development of credit is only likely to increase the rapidity of the inflation of rupee prices. The Report seems to think it an evil if gold replaces notes in the circulation, though the notes are only convertible into rupees.

The other observation is of a more general character. It may be said that the criticism here offered would apply to any form of the gold-exchange standard. So far as the conditions are essentially the same, this is quite true; but the general argument is too large to be considered in this place.

NOTE.—In a review in the *Quarterly Journal of Economics*, May, 1917, Mr. H. Parker Willis, of the Federal Reserve Board, expresses the opinion, with which I entirely concur: "... the gold exchange standard system is available only for dependent countries. In short, it is not a monetary system, but a connecting link between an isolated market and the broader market to which it looks for support."

CHAPTER IV

INFLATION OF THE CURRENCY AND THE RISE IN PRICES

Prefatory Note

[This essay was first published in the *Economic Journal* for December, 1916.]

Inflation is one of those terms so common in economics which can only be defined by reference to the proper correlative. An old word for inflation of the currency is redundancy. Redundancy means an overflow—an overflow of the channels of circulation.

In the case of paper money the term generally used for inflation is over-issue. Inflation in this sense is not synonymous with increase in volume. An increase in the currency in accordance with the growth of wealth, trade, population, etc., is regarded as normal. Inflation means an abnormal increase.

It may well be thought, *primâ facie*, that a great war such as this would call for an increase in all the forms of currency in the same way as an increase in the volume of trade or population. And in this case it may be said that account must be taken of this extra monetary work before estimating the inflation (if any) of the currency.

The question then arises: What is the test of over-issue or inflation if we cannot take merely the pre-war average?

The usual practical test of over-abundance or redundancy of inflation of any form of currency is its *depreciation*.

But the term "depreciation" itself is also a relative term, and the meaning depends on the correlative.

In the case of notes there are two distinct meanings of

depreciation according to the correlative taken, namely, (1) *specific*, and (2) *general*, depreciation.*

(1) In *specific* depreciation the notes are compared with the metallic standard on which they are based (say), gold. This was the meaning always attached to *depreciation* by the old masters, Tooke and Ricardo. Depreciation in this sense is measured by the premium on gold, *i.e.*, by the extent to which the price of gold measured in notes rises above the mint price. "During the years 1803–8, for example, the difference in the value of Bank of England notes and gold estimated at the Mint price was no more than £2 13*s*. 2*d*. per cent. In 1813 the depreciation measured in this way was £29 4*s*. 1*d*. per cent." (Porter's "Progress of the Nation," 1847 edition, p. 429).

If the notes are immediately convertible into gold without any delay or hindrance of any kind whatever, obviously they cannot become depreciated in this specific sense.

Under such conditions, however, the notes might become *appreciated* relatively to gold.

For a time in the eighteenth century Scottish one pound notes in some places were of higher value than the metallic money they were supposed to represent, mainly owing to their convenience for transmission.

It is quite possible that the present restriction of gold imports by Sweden may cause a specific appreciation of the Swedish notes relatively to gold.

During the period of the Bank Restriction in England it was maintained that the notes were not depreciated relatively to the gold, but that the gold was appreciated, owing to the exceptional war demands for gold, relatively to the notes.

Inconvertibility (absolute) of the notes does not of itself involve depreciation. Sometimes the mere fact of the announcement of inconvertibility causes depreciation by discredit, but, in general, as shown by Ricardo, due regard

* *Cf.* article on "Depreciation" by Professor F. Y. Edgeworth in Palgrave's "Dictionary of Political Economy."

to the principle of limitation will prevent specific depreciation of any form of currency.

Between absolute *in*convertibility and immediate convertibility there are all degrees of deferred or suspended or limited convertibility. Any hindrance of any kind in time or place to the immediate conversion of the notes into gold so far means imperfect convertibility. The history of banking is full of examples of optional or deferred or restricted convertibility.

In the present war, whilst France, Germany, and Russia at once adopted inconvertibility, in Britain only certain restrictions were imposed on the conversion of notes. The Treasury notes since their first issues have been convertible into gold at the Bank of England. At the same time, very early in the war restrictions were imposed on the ordinary banks paying out gold, and people were requested to use the notes.

The Treasury notes are *de facto* inconvertible (except at the Bank of England), but so far as is generally known they have suffered no specific depreciation within the country. We have not come to the pass of having a gold price and a paper price in the shops. Any small hoarder of sovereigns who released his hoard would not receive more than the nominal value in notes.

Specific depreciation is measured not only by the price of gold, but more generally by reference to foreign currency, as shown by the foreign exchanges. The principal practical problems arising out of the specific depreciation of Bank of England notes in the Restriction were connected with the foreign exchanges.

In the present war the principal efforts of the English financial authorities have been directed to preserving the stability of the foreign exchanges. Except for a short period in the autumn of 1915, there has so far been little or no specific depreciation of the English currency measured by the foreign exchanges, having regard to the new gold export point.

(2) There is, however, a *second* meaning of depreciation

which, from the point of view of the general public, is often of more importance, a *general* depreciation, namely, in the sense of a fall in purchasing power. To ordinary people who know nothing of the foreign exchanges it is this kind of depreciation that is suggested by an inflation of the currency. The inflation of the currency is supposed to be shown by the inflation of prices.

The term *depreciation* (in this general sense) came to be applied to gold itself after the alteration in the level of prices consequent on the great gold discoveries of the 'fifties. After 1875 the correlative term *appreciation* of gold came into common use as equivalent to a general fall in prices in the gold-standard countries.

Nothing can be more distinct than a fall in the value of one form of currency compared with the standard (or with any other form of currency, *e.g.*, foreign) and a fall in the purchasing power indicated by a general rise in prices. Yet it is very commonly assumed that so long as there is no specific depreciation of the English notes, the issues of such notes cannot have caused any general depreciation. That there has been a great fall in the purchasing power of the pound sterling cannot be denied. It is also clear that gold has been displaced from circulation, and that its place has been taken by notes, and in this sense the notes have less purchasing power than at the first issue. But by most people the fall in the purchasing power is assigned to causes affecting the particular commodities, *e.g.*, to war scarcity or to war demands, and not to the over-issue of the notes.

Whether the general rise in prices in this country is to be attributed at least in part to an over-issue of notes is a matter for argument, and in the last resort the verification involves a series of difficult statistical inquiries. But it is important to make clear at the outset that the mere absence of *specific* depreciation (as shown by the foreign exchanges) does not of itself disprove general depreciation due (so far) to over-issues.

It is true that the same causes tend to bring about both

specific and general depreciation, but there are also special causes at work in the two cases, and the two kinds of depreciation may move at different rates or even in different directions.

In an extreme case no doubt an enormous issue of notes will at the same time lower the value of the notes in terms of foreign currency and also lower their purchasing power within the country of issue.

But even in this case whether the *specific* depreciation shown in the foreign exchanges is the exact measure of the general depreciation in purchasing power depends on various conditions. As was remarked by F. A. Walker in his book on "Money," this question is perhaps the most difficult in the theory of money.*

Since the standard work of Goschen, the theory of the foreign exchanges has been treated by many able writers, and in our own times has received special attention from the advocates of the gold-exchange standard. It is sufficient here to remark that movements in the foreign exchanges are the resultant of a number of variable causes, and the movements may be "corrected" by various special expedients which have for the time little effect on the general level of prices in the "correcting" country.

The principal cause of any movement in the foreign exchanges is a change in the international indebtedness. If, however, the adverse balance of indebtedness is restored by the export of securities or the creation of foreign credits, the fall in the exchanges is stopped. But coincidently there may be a continued rise in prices within the country, and it is possible that this rise may be due to continued excessive issues of notes.

It may also be observed in passing that the credit of any country is only one of the causes affecting the foreign exchanges, and accordingly movements in the foreign

* *Cf.* my "Principles of Political Economy," bk. iii., chap. xv., sec. 4, vol. ii., p. 128. I once complimented General Walker on his clear treatment of this matter, and he said to me: "Do you know I was never clear in my own mind on that question."

exchanges do not necessarily reflect or measure changes in national credit.

It is commonly admitted, for example, that the general rise of prices in Russia is partly due to the excessive issues of paper money, and that these issues are also partly accountable for the fall in the foreign exchange. But it is plain that for every movement in the Russian foreign exchange or of the value of the rouble in terms of the pound there cannot be a movement in the general level of prices in Russia. Russia is too big. Nor does Russian credit fluctuate simply with the changes in the sterling value of the rouble.

Digression on the Effects of Depreciation on Foreign Trade.

The difference between *specific* and *general* depreciation is of great practical importance in estimating the effect of the depreciation of inconvertible notes on the course of foreign trade. It is very commonly taken for granted that depreciation of the notes will stimulate exports from the country concerned. Take, for example, the following statements:—"So long as the mark is at a discount there will be a *pro tanto* advantage to export trade, and although the mark may eventually regain its par value, a few months, or even weeks, will have an appreciable influence on reopening foreign business." * Or, again, this:—"Man sagt daher mit Recht: eine entwertete Valuta wirkt wie eine Erleichterung der Ausführ." †

In the same way it is held that a corresponding check will be placed on imports by the depreciation. Thus Diehl: "Die entwertete Valuta wirkt wie eine erhöhter Schützzoll." And Mr. Clare writes: "On the trade of a country depreciation and an unfavourable exchange generally has much the same effect as a protective duty. It stimulates exports and checks imports." ‡ On the other hand, Goschen writes: "It will be easily seen why it is possible to assume that a

* Professor Kirkaldy: Address to British Association, 1916.

† Karl Diehl: "Zur Frage eines Zollbundnisses zwischen Deutschland und Oesterreich-Ungarn," p. 36.

‡ "The A B C of the Foreign Exchanges," p. 153.

country in which a depreciated currency and a prohibition to export bullion exist is likely to be importing more than it is exporting.* In explaining the position, Goschen says: "Sometimes Governments simply, for their own purposes, issue a quantity of paper money; the natural consequence will be over-importation; prices will rise in consequence of the increase in circulation, and accordingly attract commodities from other markets, while the exports, having risen also (in price), will be less easy of sale abroad."

The question was much discussed at the time of the bimetallic controversy with reference to the effects of the depreciation of silver. Mr. J. M. Keynes † in his book on Indian currency supports the view that depreciation as such has little or no effect either by way of stimulus to exports or check to imports (and presumably the same reasoning would apply to paper as to silver).

The solution of this curious conflict of opinion amongst authorities who have given special attention to the question is to be found by distinguishing between the two kinds of depreciation. The truth is that *specific* depreciation will tend to stimulate exports or imports or have no special effect on either, according to the degree of the *general* depreciation (if any) which has taken place within the country concerned. Take the first case. The exporter, owing to the specific depreciation, is supposed to get more notes than before to spend in his own country after converting the foreign money into his depreciated paper. If, however, there has been a greater general depreciation, these extra notes will have less purchasing power than before. He will have to pay more in expenses of production, the expected gain will turn to loss, and exports will be checked. (Goschen's case.)

Take the second case. With a general depreciation greater than the specific the importer will obtain more notes and on conversion more gold than before in the country of origin.‡

* Goschen's "Foreign Exchanges," p. 72.

† "Indian Currency and Finance," p. 3 and note.

‡ The general argument on the effects of the two kinds of depreciation with application to silver and to inconvertible paper was given in a

The particular case of England during the present war is of special interest. There has been a continuous rise in prices or a general depreciation of the currency, with little or no specific depreciation. The natural consequence would be (so far) a stimulus to imports and a check to exports. (Goschen's case.) If this interpretation is correct, the efforts made to keep up the exchange or check the specific depreciation without at the same time checking the general depreciation have (so far) stimulated importation, and thereby increased the balance of indebtedness which has to be met by the export of securities. The large importation, apart from Governmental imports of war materials, seems (so far) to confirm this view.

This digression, however, is only intended by way of illustration of the distinction between general and specific depreciation, and is not meant to anticipate *à priori* the test of a statistical inquiry.

(End of the Digression.)

To return to the general argument, we have next to consider the causes which under normal conditions, *i.e.*, with absolute convertibility in full working order, may bring about a general rise in prices in some particular country as compared with the general world level, and the limitations imposed on that rise by the conditions of convertibility.

Before the present war England maintained the gold standard in the most effective form. Every credit-substitute for gold was convertible into gold as required. The position was sometimes explained by saying that London was the only really free market for gold. The ultimate convertibility of the notes was not only secured by cast-iron restraints on over-issue and by a gold reserve that seemed ridiculously large, but in every bank in the kingdom convertibility was a matter of common routine. The proportion of gold to notes in circulation, even in Scotland, with its one-pound

paper to the Royal Society of Edinburgh in 1888. Republished in my "Money and Monetary Problems," in the Essay entitled "Causes of Movements in General Prices."

notes well established, depended simply on the convenience of the people concerned. Some people preferred to carry gold—some notes. Anyone who cashed a cheque could state his preference. For internal purposes no restraints were imposed on the use of gold, and the notes in use were strictly limited by the Acts of 1844 and 1845. Silver and bronze were also coined simply to suit the convenience of the people. Though their legal tender was limited and their metallic value not half the nominal value, they were always convertible, and the chief complaint was of occasional local scarcity of some kind of these tokens, *e.g.*, farthings.

In any expansion of trade after a depression there was an expansion of the currency, *i.e.*, of gold notes, and token coins, to provide for wages, retail trade, etc., under rising prices. Seeing that the issues of notes were strictly limited and in England none under £5 were allowed, a continuance of the rise in prices—from whatever cause it may have originated, *e.g.*, speculation, foreign demand, etc.—was only possible with an increase in the gold available.

Of the monetary transactions of England under normal conditions the part actually effected by cash payments in the strict sense, that is to say, by coins or notes passing from hand to hand, is relatively so small that its importance is apt to be overlooked. The Bankers' Clearing Returns in 1913 amounted to over £16,400,000,000. The gold circulation probably did not exceed £160,000,000, of which about half was in the hands of the public and half in the banks, including the Bank of England.*

The amount of gold in the country compared with the work to be done seemed so insignificant as to be negligible. We were told that the real currency of the country was not the sovereign (and its metallic submultiples), but the cheque.

As a further consequence it was maintained that so far as the level of prices in any country depended on the quantity of the money, the gold was of little importance. The opinion

* *Cf.* Report of the Currency and Finance Committee of the British Association, 1916, in Professor Kirkaldy's "Labour Finance and the War," p. 231.

was confirmed by observing that the seasonal demands for currency passed almost unnoticed, and from year to year there might be great changes in trade and consequent changes in the demand for currency with little effect on the monetary system. The gold seemed to be the ornamental survival of an old system of about as much use as the buttons on a tail coat. The real thing was the cheque-book in the pocket.

The falsity of this idea, that the importance of gold and notes based on gold is to be estimated simply by the proportion to the mass of the actual currency (in which the cheque is altogether predominant), may be made clear both by reference to the meaning of the gold standard and the methods by which it is maintained. Did anyone ever hear of a cheque standard? Can anyone even explain how a currency of cheques can be maintained unless the cheques are convertible into cash as required? The American crisis of 1907 illustrates the difficulty.

The outbreak of the present war gave a vivid illustration of the vital importance of currency as distinct from credit. The suspension of the Bank Act—the old remedy for the increase of cash in times of crisis—was permitted, but was not acted on.* It was not acted on, not from any fantastical reason that our currency was a cheque currency, but simply because it was supposed that the provision of cash in this way was too feeble. As fast as possible, Treasury notes for one pound and ten shillings were printed and at the same time legal tender was assigned to postal orders. Any bank was to be allowed to get notes to the extent of 20 per cent. of its total liabilities on deposit and current accounts as shown in the monthly statement last issued before

* "The insufficient supply of Treasury notes made it necessary to issue to bankers on August 7th and 8th, 1914, a part of the advances to which they were entitled under the Currency and Bank Notes Act, in the form of Bank of England notes instead of Treasury notes . . . the excess issue reached at its highest point £3,043,000." (*Economic Journal*, December, 1915, p. 566.) This fact was not made known till about a year later, and as the Bank of England notes were only used because the Treasury notes were not printed fast enough, it is practically true to say that the suspension was not taken advantage of.

August 6th, 1914. [Cd. 7836.] Not a voice was raised against this creation of cash for the emergency—the only criticism was to the effect that the notes ought to have been already printed beforehand.

In the face of a monetary panic of this kind it is absurd to reckon the relative importance of the notes simply by the proportion to the bankers' clearings. It would be as reasonable to estimate the relative importance of the bodily organs by their weight. Nor is this insistent demand for cash to be explained as altogether exceptional owing to the sudden outbreak of war. The need for currency as the basis of internal credit was quite as forcibly illustrated by the 1907 crisis in the United States, of which one of the sequels has been a change in the banking law.

The best way to understand the effect of the war on credit and currency is to look first of all at the essence of the relations between cash and credit under normal conditions before the war. Before the war there were *three* very real limitations imposed on the rise of prices by an expansion of credit. There were three great drain-pipes which allowed the monetary cistern (to recall the metaphor which Jevons made popular) only to be filled up to a certain height.

(1) *The Internal Drain.*—There was first the drain to provide cash for payments within the country itself—the *internal* drain limitation. Every banker knew that in case of need he must meet his cheques in cash. His creation of bank money was limited by the necessary provision of, or command over, a due proportion of metallic money or its legal tender representative in notes. Cash was required for wages and various retail transactions.

As a matter of fact, the stringent regulation of notes as compared with other forms of bankers' credit (*e.g.*, cheques) has been recognised in every country, and in no country was the regulation more stringent than in England before the war. Whether the regulation was too stringent is not now the question. The point is that, under normal conditions, the limitation of the notes made it necessary, after a certain point was reached, to provide gold, and the pro-

vision of gold in a country that does not produce gold is a very different thing from handing out cheque-books or printing off notes.

(2) *The Foreign Drain.*—This necessity for the provision of gold in case of need—which is the real meaning in a practical form of a gold standard—is still more imperious when we look to foreign payments and the possibility of a *foreign* drain.

It is true that before the war to a greater and greater extent the use of gold was economised in international payments. This economy reached its most advanced stage in the development of the gold-exchange standard. But in all these economies the gold foundation was still necessary. When the proportion of gold fell below a certain point in the central bank steps were taken which directly or indirectly led to a contraction of credit.

The methods by which the stock of gold was replenished in the case of a threatened foreign drain have been explained by a succession of authorities on banking. The central point to seize is that, with all the economies of gold we never get away from the fundamental necessity of every monetary centre having a sufficient amount of gold *under its control* to ensure the absolute convertibility of its credit-substitutes. Were it not so already before the war the gold standard would have been effectively abandoned. In London the gold standard was most effectively maintained because the principle of immediate convertibility was most strictly observed. It is true that the store or fund of gold held in London was far less than in other great centres, but the flow was greater and more steady. And, as in wages, it is the flow and not the fund, that counts.

Under the conditions that prevailed before the war gold had come to be recognised as the one standard throughout the commercial world. All the other currencies and credits were expressible in terms of gold and their values were determined in reference to gold. It followed that a very close connection subsisted between the general prices in

any one country (reckoned in gold) and general world prices in the same standard.

That the levels of prices in gold-standard countries tend to equality is sometimes taken as axiomatic, and is shortly expressed by saying that gold being the standard must have the same value all the world over.

The simplicity of this assumption disappears when we look into the meaning of the value of gold. To begin with, there are all the difficulties of index numbers, of which a very able and interesting *résumé* has just been furnished by the United States Bureau of Labour Statistics.* The danger of applying general index numbers to particular problems has long been familiar. For most practical purposes we need special index numbers. It is true that in any very marked movement of prices the various index numbers tend to move in the same direction, but they move at different rates.

With regard to the tendency to equality of international prices (*e.g.*, of English prices with world prices), it can only subsist in the first place in articles capable of easy and prompt transfer in international trade. There is, for example, no direct and immediate tendency to equality in the prices of lands and houses, which are the largest values in the national inventories. The same is true of the price of labour and of the different kinds of labour. The price of labour (of a typical kind) may vary greatly when we compare England with the United States, or India, or Australia. Even as regards the great staples of international trade, prices vary with freights, and freights are subject, even in normal times, to varying influences. Indirectly, no doubt, the tendency to equality of international staples reacts on other things. The price of agricultural land in England depends largely on the world prices of agricultural produce, as was well shown in the depression that set in in the 'seventies. The international article affects the price of the home alternative. The price of labour itself depends

* *Bulletin* Nos. 173 and 181. *Cf. Quarterly Journal of Economics*, p. 796, August, 1916.

partly on the cost of food, etc., and partly on the prices of the products of labour, and both are subject to international influences.

After these and similar allowances have been made for the differences between national and international prices, it still remains true that under normal conditions national prices (measured in gold) must be adjusted to the international level. With a rise in national prices (from any cause) imports will be stimulated and things formerly on the margin of doubt will come rolling in. Conversely, as regards exports, the marginals will be retained or not asked for at the rising prices. In this way the balance of indebtedness will rise against the high-priced country. This growth of the adverse balance must in the end cause a contraction of credit, unless it is met by the export of securities or the creation of foreign credits, or some other expedient. Failing some such adjustment, there must be a drain of gold, and if the gold standard is to be maintained, the reaction on prices is inevitable, though long delayed. The long postponement may culminate in a financial crisis.

Under normal conditions the more effective the maintenance of the gold standard by absolute convertibility the sooner the restraining influence will be felt on any national expansion of prices of the *external* drain.

(3) *The Consumption Drain.*—There is one other drain—the third drain—in which may be seen the fundamental dependence of credit-prices on gold apart from the internal and external drains just noticed. After a point, rising prices and rising incomes will cause a rise in demand for the use of gold in the arts. The mint price of gold is fixed, *i.e.*, so much gold is coined into so many pounds. Conversely, if gold is wanted for the arts it may be obtained by melting down the sovereigns (this time perhaps in spite of the law).

If, however, prices could rise indefinitely with an expansion of credit the drain for consumption would absorb all the gold in circulation or in the banks if convertibility were maintained. The recent publication in this country of the

prohibition of melting down gold coins seems to show that this kind of drain is being felt or feared.

The conclusion of this part of the argument is, that so long as the principle of convertibility is strictly maintained, any national depreciation of the currency, whether specific or general, tends to bring into play with increasing force one or all of these *three* drains.

In general, however, under normal conditions, any tendency to depreciation is checked long before any one of the three drains becomes noticeable, even to the ordinary banker.

The chief reason for this restatement of the principles of the limitation of the expansion of credit-prices is to make clear by contrast the changes introduced in England through the war. The general result of our financial policy has been to replace the old brakes on the expansion of credit by new brakes on the convertibility of credit-substitutes into gold. The old regulations on the issue of bank-notes have been annulled, both as regards quantity and denomination. The issue of Treasury notes for one pound and ten shillings of full legal tender makes it possible to dispense altogether with gold for internal circulation. The removal of limits to the quantity of the issues of the notes has enabled the Government or the banks to provide against any internal drain, simply by printing off more notes or certificates.* The old check of the *internal* drain is no longer operative.

With regard to the *foreign* drain limitation, it is true that the principle of convertibility has been maintained by the Bank of England, but not by the pre-war methods. A great effort has been made to prevent specific depreciation by Governmental provision of foreign credits, so as to neutralise the fall in the exchange consequent on the increasing adverse balance of indebtedness. The specific depreciation has been counteracted or prevented without any regard being paid to the possibility of general depreciation within the country.

* The notes outstanding have risen from £43,519,019 on May 12, 1915, to £139,071,885 on November 8, 1916, with coin and bullion unaltered in the redemption account at £28,500,000.

The restraints imposed by the war on international trade have rendered the readjustment of national to international prices more difficult. Accordingly, under war conditions, it is possible that the level of prices in England may rise owing to causes affecting English credits and currency apart from any general rise in world prices. Having regard to the enormous demand by Britain and her Allies, the rise in British prices may be the chief cause in the rise in world prices of international staples. At the same time, the substitution in all the belligerent countries of notes for gold and the adoption of imperfect convertibility allows gold to overflow in the neutral countries, *e.g.*, the United States, and gold so far suffers a general depreciation.

The *third* limitation, the drain for consumption, is practically inoperative when the circulation has been reduced to notes. The efforts of the Government, however, have been directed so far to prevent the use of gold within the country either for the arts or for hoarding, so as to put more under their control for stabilising the foreign exchanges and preventing specific depreciation. The third limitation on the expansion of prices by an expansion of currency and credit is thus removed or weakened.

It appears then that the three great limitations which in normal times were imposed on the expansion of prices in the United Kingdom have been *de facto* removed.

It does not follow, however, that as a necessary consequence prices must have risen abnormally—so far only the *possibility* of an abnormal rise has been established.

As the history of the Bank Restriction (1797–1819) shows, it is possible that a rule of thumb, not founded on any recognised monetary principle, may suffice for a time to check both specific and general depreciation. As already shown, inconvertibility of itself does not mean depreciation. The essential thing is that the principle of limitation must be applied in some effective form. Bagehot said that the reasons given by the Bank of England directors (in the Restriction) for their rules regarding their note issues had become "almost classical by their nonsense." Yet for a

long time the rules were practically sufficient. The foundation of the principle of these rules of thumb was the belief that a bank rate of 5 per cent. (with the usual first-class banking securities) would suffice to check any undue issue of notes. The maintenance by the Bank of England during nearly two years of the present war of the same rate seemed to suggest a survival of the same simple faith. The recent resort, however, to a 6 per cent. rate is so far a reversion to normal methods, though it is probably due simply to the desire to support our foreign credits. It can hardly be regarded as a recognition of any inflation of the British currency—for the belief still prevails apparently that a general depreciation due to inflation is not possible without specific depreciation, and that (by the simple quantity theory), in any general depreciation the amount of notes is negligible compared with the mass of cheques.

The main contention of the present argument is that the influence of note issues on prices is not to be measured by the proportion of the notes to the cheques, but by their function in supplying a necessary part of the currency for cash transactions, and, indirectly, a necessary basis of credit. The validity of this argument under normal conditions, has been admitted by all countries, as shown by their banking regulations. In all countries stringent limits are imposed on the issues of notes. Germany, in the third year of the war, in the midst of an effort to float the "last" great war loan, has made frantic efforts to make the gold in reserve bear the legal proportion to the notes in circulation. In this country we have preserved nominally the convertibility of the notes, but we have imposed restrictions on the actual process of conversion. As regards the Bank of England notes, we have kept the Act of 1844, but as regards the Treasury notes, every principle of that Act has been disregarded. What other limitations have been adopted (beyond the original 20 per cent. of banking deposits) is not known.

Conclusion.—The general conclusion of the foregoing argument is that the conditions affecting note issues and

bankers' credits based on these notes during the war have rendered possible a general depreciation of the British currency in spite of the fact that there has been little or no specific depreciation.

The extent of this general depreciation (or alteration in the value of the whole currency, as the old writers called it) is roughly measured by the usual index numbers (*Economist*, Sauerbeck, etc.). How much (if any) of this depreciation (or *alteration*) is to be ascribed to the relaxation of the limitations formerly imposed on the expansion of currency and credit can only be determined by careful statistical inquiry. The index numbers are founded on the prices of particular representative commodities, and it is possible that in each particular case special causes may be assigned (in the manner of Tooke) for the exceptional rise. The magnitude, however, and the apparent universality of the rise in the opinion of the writer seem to show that it is due to a considerable extent to inflation of credit and currency.

In support of this view, the first approximate results of a statistical verification may be indicated. There has been a general conformity between the increases of our note issues and the rise in prices in the United Kingdom. The increase in prices as shown by the index numbers has *followed* the increases of the notes. The issues of Treasury notes and certificates have exceeded the gold displaced from actual circulation. The notes of the Scottish banks (with Governmental paper reserve in place of gold) have largely increased. In spite of the ten shilling notes, more silver coins have gone into circulation. There has been a continuous rise in wages (taking the family as the wage-earning unit) and in retail prices of all kinds. In general, the movement in prices is of the character associated with over-issues of inconvertible paper, such as has taken place in the other belligerent countries.

The rise in prices in the United States was for a time hardly appreciable, and is still very much less than in the United Kingdom.

The bankers' clearing returns also point to inflation. The

fall in the Town Clearing is accounted for by the fall in Stock Exchange and financial business in London. The Country Clearings from December, 1914, show a continued increase over the corresponding pre-war figures. The increase in the first six months of 1916 over 1915 is greater than that of 1915 over 1914. The increase in banking deposits in connection with bankers' loans to Government points to an inflation of credit.* The profitable nature of banking business (after allowance for depreciation of old investments) and incidentally, the great strength of bank shares, indicates credit expansion.† Having regard to war conditions, the rates of interest have suggested inflation rather than stringency, though the high rates paid by the Government, apparently for political reasons, tend to obscure this part of the evidence. The continued export of securities to support the foreign exchanges (coupled with the recent rise in the bank rate to 6 per cent.) suggests the artificial prevention of specific depreciation which might otherwise have accompanied the general depreciation. The course of foreign trade (as already indicated) points to the artificial stimulation of imports.

In the following chapter (V.) are given the results of the statistical verification here only broadly indicated. In attempting to determine how much of the rise in prices may be ascribed to inflation of the currency, it is important to trace the progress of this rise in prices in order of time, which is much more difficult than to make a mere comparison of present (November, 1916) conditions with pre-war (July, 1914) conditions.

* *Economist*, October 21, 1916.
† *Ibid.*, October 28, 1916.

CHAPTER V

STATISTICAL ASPECTS OF INFLATION

PREFATORY NOTE

[THIS paper was designed to give the statistical verification alluded to at the end of the previous paper on inflation. It was read before the Royal Statistical Society, on June 19, 1917, and is published in the July number of the Society's journal, with the discussion, which it was decided to adjourn to a second meeting owing to the interest in the subject. I think it was Addison who said that the critics of a book always complain most of what is omitted. Certainly this happened with my paper. The truth is that the whole subject is far too large for one paper, and most of the points raised had been treated in other papers now published in this book. Not much attention was directed in the discussion to the point emphasised in the paper of the order in time of the inflation of the currency and the rise in prices. In a paper just received (August, 1917) from Professor Irving Fisher on the "Ratio" Chart (reprinted from Quarterly Publications of the American Statistical Association, June, 1917), in a figure giving "ratio" curves of Dun's index numbers and the circulation of money in the United States it is observed that "since the war there has been a close correspondence, changes in the price level following changes in money by two or three months." Readers of Tooke will remember that his main argument against the currency theory of high prices in the Napoleonic war period was that the issues of notes followed the rise in prices. In the present war the increases of our currency notes have preceded the rise in prices.]

Guidance from Tooke's Treatment of Prices in the Napoleonic War Period

The subject of this inquiry may be introduced by a reference to the Napoleonic war period. In that period also there was a great rise in prices and a prolonged controversy arose as to the causes. Tooke's great work on the "History of Prices" originated in the attempt to test by the appeal to facts the validity and relative importance of the causes assigned. The same causes are brought forward in our present war. We may begin by following Tooke's methods. By way of preliminary he gets rid of the popular notion that of itself war causes high prices. "On reference to former periods of our history," he writes, "it will appear that there is no observable coincidence of a rise of prices during war and a fall during peace." He gives a table of war periods and peace periods and compares the prices. He deals with the objection common in his day that the war was so vast that any comparison with former wars was misleading. With regard to the currency and especially the notes of the Restriction period his first concern was to find out the facts—and in particular to find out the order of time in which they occurred. He showed that the volume of note issues was over-estimated and that the issues were not correlated to prices in order of time in the way supposed. His own conclusion was that the dominating influences were the course of the seasons and the obstructions to supply caused by the state of war. He attributes little weight to the currency. Tooke's guidance is valuable by way of suggestions and cautions. But it is *primâ facie* probable that the causes noticed by him have operated in the present war in different ways and proportions.

It is never safe to apply the results of the historical method without special regard to changes of conditions. Tooke himself admitted that his own presentation of facts might lead others to different conclusions. The object of the present paper is to outline some of the statistical aspects

of inflation. It is not meant to illustrate or prove preconceived theories.

In the previous chapter * I have examined the principal meanings of inflation, and especially the consequential distinction between general and specific depreciation. For the present purpose we may take inflation to mean an abnormal increase of the currency. What then is the normal from which an inflated currency deviates ?

The simplest and most natural answer is to take the average increase of the currency or different forms of currency over preceding periods, and compare the increase in the period of the supposed inflation.

From this point of view I have compared first of all the increases of the different forms of currency in the period of the war with such pre-war periods as may be supposed to give the normal increase.

POSTAL ORDERS

I begin with a form of legal tender which as such was unrepresented before the war, namely, postal orders. By the Currency and Bank Notes Act, 1914, (4 & 5 Geo. 5, c. 14), it was provided, s. 6, that for "the purpose of meeting immediate exigencies all postal orders issued either before or after the passing of this Act (August 6, 1914) shall temporarily be current and legal tender in the United Kingdom in the same manner and to the same extent and as fully as current coins, and shall be legal tender in the United Kingdom for the payment of any amount." It is to be noted that the postal orders were not limited as legal tender like the silver or bronze, but were like gold or Bank of England notes. This section of the Act was only revoked by proclamation dated February 3, 1915. The extent and nature of the issues of this new currency are given in the Mint Report for 1914 (published in 1916). During the fortnight ending August 20, postal orders over 13 millions in number of the value of 4·6 million pounds were issued compared with

* "Inflation of the Currency and the Rise in Prices," *Economic Journal* December, 1916.

5 millions in number and 2 millions in value of the corresponding fortnight in 1913.

Early in September, however, it is stated that the number of currency notes in circulation allowed of a reduction of the number of the postal orders in the hands of the public.

So far then the postal orders may be considered as the beginnings of Treasury notes or the germ of the inflation.

By the end of October the value in the hands of the public did not exceed the normal amount, viz., £1,500,000, though the number was considerably larger owing to the preponderance of orders of the lower denominations. This situation, it is explained, was due to the shortage of silver coin in some districts, particularly in Ireland and in military centres.

The Silver Coinage

I take next the increase in the silver coinage. As the basis for comparison we must find the normal rate of increase before the war. A table is given in the Mint Report for 1914 of the issues of silver and the withdrawals in the United Kingdom from 1872–1914 (*cf. infra*, p. 109). A glance at the final column of net issues shows very striking variations from year to year. Omitting 1914, on four occasions the net issues were above one million in value, but in no less than ten separate years the withdrawals exceeded the new issues so that on balance there was a decrease. The average for the forty-two years (omitting 1914) was about £350,000. The year 1909 showed a net loss, but for 1910–13 there was an average increase of nearly £875,000 per annum.

The Deputy-Master of the Mint has kindly given me the figures for the period of the war in quarterly returns (*cf. infra*, p. 108). The net issues for the five months of war in 1914 were £5,327,899. This compares with £318,000 of the first seven months before the war, that is about seventeen times as great. The monthly increase for the five months is about thirty-five times the normal monthly increase of the forty-two years, and fourteen times the monthly average of the four preceding years (1910–13) of very high issues.

The net increase in silver in 1915 and in 1916 was in each year about eight times the annual average of the four pre-war years.

BRONZE

It might be supposed that bronze being small change for silver, there would be a very close conformity between their net issues. On the contrary, there are some remarkable divergencies.

From 1901–09, for example, there was in bronze a net increase of over one million in value, whilst in silver there was a net decrease of about £300,000 for the nine years. In 1910–11 the issues of bronze were below the average of the period 1900–13, whilst the issues of silver were more than double of the average.

In bronze the annual average of issues 1900–13 (Mint Report for 1914) was £173,947. Allowing for Colonies, etc., and withdrawals the annual average may be put roughly as £150,000. The annual average for the two years before the war was more than double of the average for the period, and in this case coincided with a corresponding increase in silver.

The period of the war shows the same absence of precise conformity of bronze with silver. The issues of bronze from August to December, 1914 (£132,000), did not exceed the average of 1912–13. In silver, on the other hand, as already shown, there was an enormous increase.

The increase in bronze in 1915 was again below that of 1912–13, whilst the issues of silver were far above. In 1916, however, bronze rapidly increased to £450,000, and for the period of the war to the end of March, 1917, the net increase was £951,689 (*cf. infra*, pp. 110, 111).

GOLD

In the Report of the Committee of the British Association on Credit and Currency (1916) an estimate is given, founded on Mint Returns, of the pre-war amount of gold * in the

* The Mint Returns refer to Imperial gold coin. The Bank of England especially held bullion and foreign coin.

United Kingdom. The estimated amount June 30, 1914, was 161·1 million pounds, of which 82·8 million pounds were held by the banks and 78·3 million pounds by the public.*

According to this estimate the gold coin in the United Kingdom increased from 100 million pounds in 1903 to 113 million pounds in 1910, or less than 2 million pounds per annum. From December 31, 1910, to June 30, 1914, the estimated increase was 48·1 million pounds, or just under 14 million pounds per annum.

From figures given in the Mint Report for 1914 (p. 10), it appears that for the year ending June 30, 1914, the net increase of gold coin for the United Kingdom, after allowing for withdrawals and export (but not for other sources of wastage), was 15·3 million pounds. It is noticeable that the returns of the gold † held by the United Kingdom banks on the same date were the largest on record, being 82·7 million pounds, *i.e.*, 13 million pounds above 1913 and 37 million pounds above 1910. The issues by the mint during the six years ending June 30, 1914, were 146·5 million pounds and the withdrawals in the United Kingdom 17·1 million pounds. The balance of exports for the same period was 76·2 million pounds. The net amount taken abroad by travellers or lost was not known. This gives a net increase in the six years of about 9 million pounds per annum. It will be seen that of the large increase from June 30, 1913, to June 30, 1914, namely, 15·3 million pounds, 13·3 million pounds was taken by the banks, leaving only 2 million pounds for the general public.

In the Circular dated December 31, 1914, of Messrs. Mocatta and Goldsmid (Mint Report, p. 89), it is stated that since the outbreak of war the Bank of England received the enormous addition of 64 million pounds in bars and coin, considerable amounts being purchased and left in South Africa, Canada, and other parts of the Empire. The withdrawals for the same period were only 2 million pounds

* Jevons' "Money," p. 165, gives the gold in circulation in 1873 as £100 million pounds, gold bullion in the Bank of England 15 million pounds, silver 15 million pounds and bronze 1⅛ million pounds.

† See note on p. 85.

in addition to 18½ million pounds set aside for the redemption of the Treasury notes.

Treasury Notes

In spite of this strong gold position one of the chief concerns of the Government in the first five months of the war was to issue currency notes for one pound and ten shillings ostensibly to take the place of the gold. The amounts of these issues are recorded week by week and the outstanding amounts give the quarterly increases. The general results are that at the end of December, 1914, the amount outstanding was 38·5 million pounds; in December, 1915, it was 103·1 million pounds; in December, 1916, 150 million pounds.

As in this case we start from a zero issue the five months' issues of 38·5 million pounds are net additions at the rate of 91 million pounds a year. The average for the years 1915–16 is 55 million pounds.

Other features in the growth of the currency notes are considered in later sections. Here, as we are dealing with increase of currency, we have to notice the effect of gold withdrawals. It is sometimes said that Treasury notes have simply displaced so much gold from circulation, and so far cannot have caused any inflation of the currency.

If the gold had been definitely withdrawn or called in this contention would be valid. But, in fact, the Treasury notes were issued before there was any limitation of the gold in circulation. The gold was only gradually displaced from circulation, and even as it was being displaced it still formed part of the monetary power of the country. It was not (to any appreciable extent) either hoarded or made into ornaments. It is possible that for a time larger amounts than usual were held by the banks, but with the very object of strengthening their monetary position.

Except then as regards the gold held against the currency notes the new notes for internal purposes were, to begin with, exactly the same as an addition of so much gold.

Accordingly, in estimating the increase of different forms

of currency we ought to compare the Treasury notes with the gold formerly issued. The net amount issued the year before the war was fifteen millions, which was a good deal above the average.

But in the first five months of the war to December, 1914, we have 38·5 million notes—less gold for redemption 18·5 million pounds—*i.e.*, a net addition of 20 million pounds in five months. The additions to the outstanding amount by December, 1916, were 111·6 million pounds. The gold held against the notes was increased by 10 million pounds to 28·5 million pounds, but this gold (it is said) was not originally displaced from the currency but obtained from abroad. The rate of increase of the notes 55 million pounds per annum, 1915–16, as compared with gold, is nearly six times the normal, 1908–14, and over 3½ times the highest year (1913) before the war—15·3 million pounds. If we deduct the additional 10 million pounds of gold the rate of increase is 50 million pounds per annum.

The increases in the note issues of the banks of the United Kingdom are for the present purpose of little importance, as after a point they are normally in effect a kind of deposit receipt against gold, the authorised fiduciary issue being fixed. The new Treasury notes are supposed to take the place of gold for this purpose.

In July, 1915, (*Bankers' Magazine*, August, 1915), compared with July, 1914, there was an increase in bank-notes of the United Kingdom of 12·7 million pounds. Of this increase the Bank of England held 4·8 million pounds against gold, and the Scotch and Irish banks 7·8 million pounds against gold and silver coin (the gold presumably being largely currency notes).*

CHEQUES

In recent years people have become accustomed to speaking of the cheque as the principal form of our currency. In 1913, the aggregate London Bankers' Clearing House

* The later figures have not been extracted for the reason given in the preceding paragraph.

Returns were 16,400 million pounds. And these returns by no means include all the cheques in the kingdom. Still sixteen thousand millions of cheques is two hundred times the 78 million pounds which was supposed to be the amount of gold in the hands of the public before the war.

Passing over for the present the question whether in considering inflation cheques are properly described as currency, it is interesting to notice that taking the Clearing House totals from August, 1914, to December, 1914, there was a *decrease* of 33·8 per cent. as compared with the same period in 1913. The total for 1915 was 13,407 million pounds as against 16,400 million pounds of 1913, a decrease of 22 per cent. The total for 1916 still shows a decrease of over 1,100 million pounds compared with 1913. The first monthly increase is shown in November, 1916, and was followed by a decrease the next month. Even the first quarter in 1917 still shows a small decrease in the total clearings.

From these figures alone it would seem that in what is now called the most important form of our currency, instead of an abnormal increase as in the other forms, we have a remarkable decrease.

Even in normal times, however, as explained in the annual reports by Mr. R. Martin Holland, we must separate the different clearings. The metropolitan, country and provincial cheque clearings give a much better indication of the volume of the trade of the country as distinct from the finance which can be obtained from the town clearing. The various restrictions imposed on financial dealings in the war have intensified these differences. In the Report of 1915 it is said that the fall in the total is altogether financial as distinct from commercial, and is due to the absence of Stock Exchange settlements, foreign loans, etc., and the reduction in the daily turnover of short money.

When we look to the country clearings alone we find the increase in the war period begins almost at once. The total country clearings for 1915 were 1,567 million pounds compared with 1,389 million pounds for 1913, an increase of

178 million pounds or 13 per cent. The year 1916 showed an increase of 483 million pounds over 1913, which was itself a record year. This is an increase of 35 per cent. as compared with 6 per cent., the highest increase for any previous year.

Here, then, we seem back again to the more common type of our war increases—the increase being more than five times the pre-war rate of increase.

With the same level of prices the increase in the country clearings may be said to measure roughly the increase in the volume of trade. If we take account of the fact that the index number (*Statist*) for 1913 was only 85 and had risen in 1916 to 136, it follows that there must have been some decrease in the volume of trade. A rise of prices of 60 per cent., if the volume of trade* had remained the same, would so far have raised the country clearing returns in the same proportion. The figure for 1913, namely, 1,389 million pounds, would have become 2,222 million pounds, but in fact it came only to 1,872 million pounds, an increase of 35 per cent. only.

Deposits

Cheques are drawn against bank credits, and it is therefore more satisfactory in estimating any general inflation to go back to the funds on which the cheques are drawn.

The growth of bank deposits is given in the *Economist* banking numbers. In 1913 the aggregate was 1,104 million pounds, including 61 million pounds for the Bank of England. In 1914 the aggregate had increased to 1,290 million pounds (including the Bank of England), *i.e.*, by 186 million pounds. Before the war the increase in deposits for the last ten years had been on the average 30 million pounds a year, so that in the first five months of the war the rate of increase was about six times the annual normal.

In 1915 the Bank of England showed an increase of only 5 million pounds over 1914, and in 1916 the increase was

* Mr. Kitchin has made the following note: Volume of trade on *Statist* figures with 1913 = 100, for 1914 = 86½, 1915 = 86½, 1916 = 81.

only 9 million pounds, but the other banks gave increase of 118 and 201 million pounds respectively. The increase in 1916 was like that of 1914—at about six times the annual normal rate. In two and a-half years of war there was an absolute increase of about 50 per cent. on the pre-war total.

GENERAL VIEW OF THE ABNORMAL INCREASE OF CURRENCY

Before proceeding to the abnormal rise in prices it will be convenient to summarise the results of the inquiry into the abnormal increase in currency.

The method adopted has been to compare the pre-war rates of increase with the rates of increase in the period of the war of the various forms of currency. In the case of new forms, *e.g.*, postal orders and currency notes, the comparison has been made with the forms of currency which they were intended to supplement or displace.

The increase in the rate of expansion has not been uniform. It might be supposed, *à priori*, that the different forms of currency being interchangeable according to the convenience of people, there would be no serious alteration in the relative proportions, as there would be no important changes in the monetary habits of people. The shock to credit and the demand for the conversion of notes into gold only lasted a few days. People soon resumed their usual habits as regards the use, for example, of cheques, notes, and coin. The new Treasury notes gradually took the place of gold without any disturbance.

It is also often supposed that if for any reason there is a general rise in prices there must be a corresponding and proportionate increase in the various forms of currency to do the money work at this higher level. At present we are not concerned with the causes of the change in the level or the nature of the connection between the money and the work to be done by it ; we are only considering the fact of the increase in general prices and the effects on the particular forms of currency.

I remember when I was giving evidence before the Gold and Silver Commission of 1888, Lord Herschell, the chairman,

expressed a doubt whether a rise in prices of necessity involved the use of more token currency. With a highly developed cheque system the doubt may be carried on even to standard money and the notes based on it. With a rise in prices cheques may be used for transactions which at a lower range required coin or notes. In this way less money so far would be required with a rise in prices. In his Budget speech Mr. Bonar Law called attention to the greatly increased revenue from the penny stamp on cheques. Again, with a twofold rise in prices it does not follow that double the amount of small change is required. I will leave the mathematical reasoning to Professor Edgeworth, but an example may serve for illustration. If a thing before the rise cost fifteen shillings, that could be paid for with half a sovereign and five shillings silver. After the rise to thirty shillings, three half-sovereigns (or ten shilling notes) would suffice.*

In the present war expansion of currency the increase has certainly not been uniform in every kind. For a considerable time the total amount of cheques actually decreased in aggregate value, and at the other end of the scale up to the end of 1915 the increase in bronze was below the increase in 1912–13, though it is true that by the end of 1916 bronze also had caught on to the general expansion.

Different forms of currency are adapted to different uses, and the amounts used will vary with any great change in these uses. The fall in the aggregate total of cheques is accounted for by the closure for a time of the Stock Exchange and the continued suppression of speculation in securities and in new companies. The tardiness in the expansion of

* I put the problem to Professor Whittaker and he brought it before the Edinburgh Mathematical Society. A paper was read by Dr. Lester L. Ford on "The Effect of a Rise in Prices upon the Amount of Small Money used," published in the Proceedings, Vol. XXXV. (Part 2), Session 1916–17. Two conclusions may be quoted: (1) "When the transactions involving small sums are sufficiently predominating the amount of small money used varies with the prices." (2) "The chief effect of an increase in prices on small money is the greater use of the larger denominations of small coins." These results seem to be confirmed by the great increase of token coins with the rise in prices in the war and by the relative increase of silver as compared with bronze.

bronze perhaps indicates that the very poorest, *e.g.*, the old-age pensioners, were the last to feel the rise in money incomes. Possibly the great increase in minute currency in the other belligerents may be due to the poverty of the people in view of the great rise in the cost of living. They need very small change to get very small amounts of consumable things.

With these cautions in mind we may now attempt a general summary of the rates of increase. The rise in the rate of increase is greatest in silver. The issues have increased by more than 7 million pounds a year, which is about twenty times the average of the forty-two years 1872–1913, and about eight times the average of the four years preceding the war. As will appear later on, this increase in silver is closely connected with the increase in wages and earnings.

The increase in cheques of a commercial character as shown in the country clearings is about fivefold the pre-war rate of increase.

In the bank deposits the increase has been about six times the normal rate.

In bronze the increase was below the pre-war rate up to 1916, but during that year rose to more than threefold the average. The aggregate clearings of cheques (for the reasons given above) only began to exceed the pre-war total at the end of 1916, so that in this case the normal rate of increase had not been kept up, but, in fact, had been turned into a considerable decrease.

The chief difficulty is as regards the Treasury notes, and the extent to which they have been substituted for gold. To estimate properly their share in the general progress of the inflation we ought to put the withdrawals of gold from time to time against the increases in the outstanding amounts of the notes. The manner, extent, and times of the withdrawals of the gold and the monetary uses of the gold withdrawn are not known. It appears, however, that the notes were issued much faster than the gold was withdrawn. As these notes were ostensibly intended to take the place of gold the increase of issues should be properly compared

with the pre-war increases of gold. At the end of 1916 the gold in the Bank of England had increased by about 18 million pounds, and there was also held 28½ million pounds against the Treasury notes. If we deduct these amounts from the 82½ million pounds held by the banks before the war and suppose that the remaining 36 million pounds, together with the 78 million pounds in the hands of the public, has been entirely displaced by the notes, the outstanding amount at the end of 1916, viz., 150 million pounds, is only 36 million pounds above the pre-war amount of gold coins. This increase would be only about the same as the rate of increase in gold from December, 1910, to June, 1914.*

From another point of view, however, if we look to the increase in bank deposits of about 50 per cent. on the pre-war aggregate and suppose (as above) that notes have been substituted for nearly half the amount of gold formerly held by the banks, and that the banks have the power of increasing this paper reserve practically as much as they think fit, this aspect of inflation demands special consideration.

Bank of England notes have increased in circulation by about 10 million pounds, and Scotch notes by 16 million pounds, but these and other note issues under our system must keep either gold or currency notes against the excess

* How far the currency notes have actually displaced gold either in active circulation or in the banks can only be conjectured. The point I wish to emphasise is that the displaced gold (except so far as hoarded by private people or melted or smuggled abroad) has still been a part of the monetary power of the country. In other words, if the gold had not been displaced by the currency notes the inflation must have been contracted by the drain on the banks. Mr. Kitchin has furnished the following comment: "According to a statement by Mr. McKenna the best estimate the Mint was able to make for gold in the hands of the public was 75 million £ at June 30, 1915. The figure seems astonishing as gold had practically disappeared from circulation in London though in the North, I believe, clung to. The amount has presumably largely fallen since. As the estimate for 1914 was 78 million £ the figures for 1915 show that 46,600,000*l*. of Currency notes had only displaced 3,000,000*l*. of gold. I distrust the official figures (for gold) and in any case the amount must have largely ceased to be circulating and have become hoarded." A good many contributions were made in gold to the 1917 War Loan. Just before reading my paper I was told in an Edinburgh branch bank that £40 had been paid in that day by a commercial traveller.

over the authorised issues. Accordingly, we cannot properly add these notes to the currency notes.

From the importance assigned to silver in the latter part of this paper it would be interesting to know the absolute amount before the war. I know of no official return. We know, however, that from 1872–1913 the total of new issues was 28·9 million pounds and of withdrawals of worn coin of 14·1 million pounds. If we suppose that the withdrawals had practically got rid of the old silver the pre-war amount would be about 29 million pounds. The increase of nearly 21 million pounds in the war would be about 70 per cent. It is quite possible, however, that the pre-war amount of silver, owing to various wastages, was much less than 29 million pounds, and the amount of silver may well have been doubled in the war.

The Abnormal Rise in Prices

The index numbers of the *Economist* and *Statist* and the Board of Trade are so well known that for the present purpose a brief sketch of the general trend of prices as thereby shown will suffice.

In the first six months of 1914 there had been a slight set-back to the rise in prices that was in progress more or less since 1896, though there was some recovery in July.

After the outbreak of war to the end of September there was a sharp rise of nearly ten in the *Economist* index number. In the last quarter, however, of 1914 the index number was practically stationary. The rise in food was more than counterbalanced by the fall in textiles and minerals.

By the end of 1915 a considerable rise had been effected in all the groups on the pre-war figures, the figures being 165·1 for December, 1915, compared with 127·3 for December, 1914. The rise continued in 1916 in every group—the figure for December, 1916, being 222. The latest *Economist* index number available for April, 1917 gives 244·5, as compared with 116·6 at the end of July, 1914. The *Statist* figures are 82·4 for July, 1914, and 168·4 for March, 1917.

The doubling of these index numbers in less than three years compared with previous records is altogether abnormal. The abnormality of the rise is perhaps best shown by the fact that the percentage rise in the war period has been more than twice as great as in the whole period 1896–1914. The *Statist* numbers, for example, are, for 1896, 1914, and March, 1917, 61, 85, 168.

The advance in retail prices that enter into workmen's budgets are too well known to require any comment.

The difficulty, indeed, is to find any exception of importance to the universality in the rise in prices of commodities. Even in luxuries, in which a fall might have been anticipated, a rise has occurred—*e.g.*, in the sales of pictures. It was stated in connection with the restrictions on racing that blood-stock horses have greatly fallen in price. It is probable also that some forms of house property have also fallen, though this is partly due to the rise in the rate of interest—and movements in interest-bearing securities of all kinds do not follow the same laws as prices of commodities.

The Abnormal Rise in Money Wages

The *Labour Gazette* records the changes in the rates of money wages (including war bonuses) in important industries, and compared with pre-war periods there can be no doubt as to the abnormality of the rise. The net effect of all the changes in wages during the twenty-one years 1896–1916 is an increase of £2,000,000 on the weekly rates. The greatest increases in any single year were £677,700 in 1915, and £595,000 in 1916. Previous to the war the greatest increases were £208,588 in 1900 and £200,912 in 1907. The total increase in the two years of war is nearly double the total increase for the nineteen years before the war.

A complete account cannot be given of all the changes in the rates of wages since the beginning of the war (as many of the unorganised employments escape observation), " but up to December, 1916, nearly 6 million workpeople had received some advance. The amount varied, but the average

was about 6*s*. per head per week, and in some of the war industries 10*s*. to 12*s*." *

These calculations take no account of increased earnings of overtime. We know also that there has been a great shifting upward of labour from stratum to stratum, and that many women and children have entered the ranks of the wage-earners, and older men have re-enlisted. It would appear, then, that the rise in family earnings has been greater than in rates of wages. Account must also be taken of allowances to war dependants, which on balance have probably more than compensated the absence of the men. I will only add that taking the last figures available—April, 1917—the changes in the rates of wages affected over 1,470,000 people, and gave a net increase of £300,000 per week. This is the largest monthly increase ever recorded.

How far this rise in money wages or in family earnings has been accompanied by a corresponding advance in real wages or earnings is, of course, quite another question.

The Abnormal Rise in Profits

The abnormal rise in profits is made clear from the returns to the excess profits' tax and the income tax.† There are certain difficulties in the calculations of the rise in profits—there are no returns ‡ of any *Capital Gazette*—but there can be no doubt that the rise has been altogether abnormal. It has also been general—as shown by the profits of the great distributing firms.

It is clear that the abnormal rise in prices of commodities must be reflected in a rise in wages or profits, or both—the prices obtained from the products of labour and capital give their rewards.

As already shown, in the present war both have risen. It is generally found that in a period of rising prices the rise

* *Labour Gazette*, p. 3, January, 1917.

† In 1914 income and property tax (with super-tax) yielded 47 million pounds, and in 1917 205 million pounds. Excess profits' duty, *nil* in 1914, in 1917 yielded 140 million pounds.

‡ The *Economist* publishes figures for the profits of trading companies, but points out that they are imperfectly represented, *e.g.*, as regards shipping.

in wages lags behind the rise in profits. The recurring labour unrest is largely due to the belief of labour that such has been the case in the present rise of prices. The extension of Governmental control also points to the same result. The control is largely a remedy for the high profits.

Connection of the Abnormal Increase of Currency with the Abnormal Rise in Prices

At first sight we are tempted to look simply to the final results, and to apply the quantity theory in the simplest form, and to say that obviously the increase in currency is the cause of the increase in prices.

The quantity theory, however, cannot be accepted in this simple form, even after allowing for rapidity of circulation. An alternative explanation of the relation between the two increases is that the rise in prices is due in the first place to obstruction of supply and intensification of demand, and that with rising prices more currency has been called for to do the monetary work. This order of events was illustrated by Tooke in important test cases, and admits of an adequate theoretical explanation. Prices may rise, first of all, through speculation, and it is only when the inflated prices have to be translated into money wages and other incomes that the real demand for more currency arises. If the country concerned has an effective metallic standard eventually the demand for gold checks the speculation. If, however, the effective reserve is paper, which can be increased indefinitely, the rise in prices so far may continue indefinitely. In this case, however, we may still say that the *causa causans* is the speculation.

There are, however, cases in which it is clear that the rise in prices is to be ascribed to the increase in currency and not the converse. Take, for example, the increase in silver in the sixteenth century and of gold in the nineteenth. Again, there are the great historical examples of the issues of inconvertible notes, as in John Law's Bank and the assignats of the French Revolution.

In this connection it may well be argued that in the

course of time our currency notes have become *de facto* inconvertible for internal purposes. Accordingly, we should expect on this analogy that so far the prices would rise in response to the issues, and not the converse.

It often happens that the rise of prices begins with a rise in demand for important commodities, the rise being accelerated by speculation. Such a rise, however, cannot be maintained or advanced beyond certain limits unless there is an increase in the currency required for cash payments. In this sense, then, the continued rise in prices may be attributed to the inflation of the currency, although the excess of issues may follow the original rise in prices.

In the present case there was no doubt a sudden war demand for certain things. During the first five months, however, general prices did not rise much. There is no doubt also that in spite of the efforts of Government at control, as soon as prices began to move speculation was stimulated. Through the excessive provision of emergency currency, followed by continued increases, no effective monetary restraints were imposed on the rise in prices.

It is also possible that a rise in prices may begin with an increase of currency, *e.g.*, inconvertible notes, and then at a later stage the rise in prices, aided by speculation, may call for more currency.

The limits of this paper do not admit of any discussion of these theories, which go back to the Napoleonic period. It is interesting to recall the fact that the late Sir Robert Giffen discussed the alternative connections of currency and prices in the old bimetallic controversy in a paper in the *Nineteenth Century* for November, 1889, in an article to which I made a reply in the next number.*

The proper test to apply in any particular case in considering the relations between the two increases is the order in time. This was the test applied by Tooke with such effect in the old controversy arising out of the Napoleonic bank restriction.

* My paper is reprinted in my "Money and Monetary Problems," p. 381.

What we ought to do is to trace the growth month by month, or quarter by quarter, of the two phenomena, and not merely to look at the final results, as in comparing June, 1917, with July, 1914.

Unfortunately figures are not available for the quarterly increases of bank deposits. It is to be hoped they will be forthcoming after the war.

In the meantime, however, as explained in connection with cheques, it is sufficient to notice that the bank deposits are left in the air unless connected with cash in the form of coin or notes.

We may then apply the order in time test in the case of the Treasury notes and of silver—as gold is no longer an effective part of the circulation.

Treasury Notes and Prices

Seeing that the Treasury notes have taken the place of gold internally, they may be said to form the most important part of the legal tender currency. Fortunately also continuous records are given of the Treasury notes outstanding, and comparisons may be made with the monthly index numbers. By way of preliminary I took quarterly periods and compared the two sets of increases.

The object in view was simply to discover the general bearing of the connection, and not in any way to establish any proportion, even if such a problem were soluble.

The general result of the first rough comparison is indicated in the tables of difference of index numbers and outstanding notes (see p. 107).

If we compare the *same* periods quarter by quarter, there does not seem to be any connection. In the last quarter of 1914 the notes increased by over 10 millions (or 35 per cent. on the amount outstanding at the end of September), but the index number remained practically stationary. In the first quarter of 1915 the Treasury notes only increased by little over one million or less than 3 per cent., but the *Economist* index number rose 22·9. Again, in the quarter ending September, 1915, whilst the Treasury notes were

increased by over 25 millions—a percentage rise in the quarter of over 50 per cent.—the *Economist* index number rose less than 4 per cent. The general result is that there seems to be no connection discoverable between the notes and prices, taking the same quarters.

If, however, the comparison is made of the note increases in one quarter with the index number increases in the following quarter, then there is a remarkable correspondence.* For example, the large note increase in the December quarter, 1914, is followed by the large index number increase in the next quarter—March, 1915. The slight increases of notes in the next two quarters are followed by slight increases only in index numbers. The very large increase in notes in the September and December quarters of 1915 are followed by large increase in the next two quarters in index numbers.

For the remainder of the war period up to the present time the correspondence in quarters is not so striking, but the general trends of expansion are the same (see pp. 112–114).

It must always be remembered that there are other currency influences that have to be taken account of, especially silver and bank deposits. There are also all the causes affecting commodities.†

With regard to bank deposits, I regret that I have not been able to get quarterly periods. The comparison with the note issues and with prices would be of great interest.

Silver and Prices

We are apt to be so overwhelmed with the magnitude of our cheque system and our gold resources that we are inclined to pay no attention whatever to the silver part of our currency. A little reflection, however, shows that when we follow out any market demand into its elements we are

* In his paper entitled the "Ratio" Chart in the publications of the American Statistical Association for June, 1917, Professor Irving Fisher draws attention to a similar sequence in the United States.

† In the general quantity theory the volume of trade and transactions must always be taken account of. Disturbances in relative prices, owing to changes in demand and supply, indirectly affect general prices (as in index numbers). *Cf.* my "Money and Monetary Problems"—Essay on "Causes of Movements in General Prices."

always brought back to the wants and the means of the individual consumers. But the great mass of the consumers of the great staples are the wage-earners, and a great part of their purchases are made with silver.

Although in dealing with silver and prices, as in the case of the other forms of currency, reference is made only to the quantity, it may be noted that especially under modern conditions silver has great rapidity of circulation. The nimble sixpence is more nimble than ever. A cheque is extinguished after one transaction, but in the course of a year silver might very well change hands fifty times, and in that way an addition of twenty millions would be equal to a thousand millions used once.

For the period of the war Quarterly Mint Returns are fortunately available (see p. 108). But before coming to the period of the war attention must be directed to the connection between silver and prices in the pre-war period.

The records of the net issues of silver from 1872–1914, and the very striking variations in the annual amounts, have been referred to in a former section (p. 84, and for table of silver issues, see p. 109). I tried to find some correlation between the general movements of prices as indicated by the index numbers and the increases and decreases in silver.* From 1872–1896, there was a great and continuous fall in prices, and thereafter a great and continuous rise. In a very general way, if we look to the beginning and the end of the period, we find a conformity. In 1872 silver issues were over a million pounds (being more than three times the average of the forty-two years), and again from 1910–13 the issues of silver were double the annual average. Between these two extremes the issues of silver on ten occasions showed a net decrease. But I could

* Mr. Kitchin notes: "Net silver issues showed maxima and minima with prices, trade and other factors. Compare maxima (trade factors in brackets):—1872 (1873), 1883 (1881–83), 1889 (1889–90), 1896 (no correspondence), 1900 (1900), 1906 (1906–07), 1912 (1912–13). But the curves nevertheless, as you say, compare badly. They are better in trade than in prices."

find no discoverable connection between the fluctuations from year to year, or even in short periods of several years. Two examples may be given. The years 1874–75 were years of rapidly falling prices, but the net issues of silver were a good deal above the normal. Again, from 1889–96 the fall in prices was most marked, and, indeed, 1896 is the minimum of the long depression from 1873. But the net issues of silver were very greatly above the normal. In fact, 1889 is the year of the maximum net issue of silver over the whole period of forty-two years, and the average of the short period 1889–96 was more than double of the normal. Again, though from 1897–1900 prices were rising and the silver net issues were a little above the normal, there followed a period of nine years (1901–09) in which prices were rising, and yet on balance the withdrawals of silver exceeded the new issues. From 1910–13 silver net issues were more than double the normal, and prices rose. Over the whole period, however, the want of conformity is much more striking than the converse. From 1873–1910 the net issues of silver were much larger during the period of falling prices to 1896 than during the period of rising prices 1896–1910.

But when I made the comparison of the silver issues with the movements in money wages, the result was surprising.

Silver and Wages

The comparison of the net issues of silver 1872–1913 with money wages, unlike the comparison with prices, shows a close conformity. With 1900 as the basis of 100, wages rose 1871–75 from 77 to 86. The net issue of silver for 1872 was over one million pounds, and for the four years 1872–75 the average was £600,000, as compared with the yearly average for the whole period of forty-two years of £350,000. From 1876–1880 wages fell from 86 to 82, and the withdrawals of silver exceeded the issues by £50,000 per annum. From 1881–84 the net issues of silver were about the average, and wages rose slightly. In the next two years, 1885–86, the issues of silver fell below the average with a slight fall

in wages. In 1887–91 there was a great increase in the issues of silver, being for the five years more than double of the average, 1889 being the maximum of the whole period. Wages (1887–91) rose from 83·1 to 91·6. From 1892–95 the net issues of silver fell as compared with the high level of the previous five years, but were still above the average. Wages fell slightly from 90·2 to 89·3. From 1896–1900 wages rose very much—from 90·2 to 100. The issues of silver were about the same as in the previous four years, *i.e.*, 24 per cent. above the average. There was, however, a great rise in wages—from 90·2 to 100. In this case the rise in silver was not so marked as in the other periods—probably owing to the exceptionally large issues of the nine years preceding. For the whole period 1887–1900 the net issues per annum of silver were £200,000 above the average, or about 57 per cent., and wages rose from 83·1 to 100.

From 1901–05 the issues of silver were a good deal below the withdrawals, and wages fell from 99 to 97·3. With increasing silver, 1906–08, wages again rose, but fell again in 1909 with a fall of silver to a net loss. From 1910–14 wages rose from 100·7 to 106·5, with very large issues of silver—more than double the average.

The comparison is made closer if the employment curve is combined with the money wages curve.*

The closeness of the conformity of increases in the net issues of silver with rises in money wages and earnings suggests a causal relation, which is found in the fact that wages are largely paid or expended in silver. Conversely, if we find large increases in silver we may expect to find rising wages or increased earnings. Of course, silver is used by other people as well as by the wage-earning classes, and wages are paid partly in gold (or under present war conditions in currency notes).

Coming now to the war period, in the first five months of

* In making these and other comparisons I have been much indebted to the excellent set of curves by Mr. Joseph Kitchin, who has also kindly looked over the proofs and given the notes indicated.

the war, as already shown, there was an increase in the net issues of silver of over £5,200,000. There were besides over two million pounds of postal orders (above the normal) used as legal tender. There were also the 38½ million pounds of Treasury notes which in that period had certainly not displaced gold. There was, in fact, a very large increase in the currency to provide for an emergency which had rapidly passed away.

In these first five months, however, there was no corresponding increase either in prices or in wages. Wages were on the whole practically stationary, and yet in the first quarter of 1915 a net issue of silver was again made of nearly 1½ million pounds—*i.e.*, more than the maximum of any single year in pre-war times.

The rise in wages began in February, and there was far more than enough of currency to support it. A fall took place in the net issues of silver in the next quarter ending June, but the million was again passed in the September quarter, and in the December quarter there was the enormous increase of over £4,000,000. This unprecedented increase in silver was accompanied by an unprecedented increase in the rate of wages. The increase in family earnings must have been much greater. Over seven millions of new silver were issued in 1916, and the rise in earnings continued.

Of course, I do not mean that the increase in silver of itself raised wages. The increase in silver was part of the general inflation which rendered possible the continued rise of wages. Notes are also used in the payment of wages, and some kinds of wages follow prices.

The connection of wages and prices in order of time varies in different cases. At the beginning of the war the special war demand, backed by Governmental funds, raised some kinds of wages. Substitution and sympathy raised others. With the expenditure of the new earnings prices rose in response to the fresh demands. Then came the demand for war bonuses to meet the increased cost of living. The special war bonus was followed by the general sympathetic war bonus.

Such a rise in wages and in earnings was only possible with an increase of currency—silver and notes. If the restraints of peace time on the issues of currency had been in force a monetary crisis must have put an end to the rise.

Other evidence, *e.g.*, the relative stability of prices in the United States of America, which can here be only alluded to, confirms the conclusion that the rise of prices in the United Kingdom is greatly due to the relaxation of the normal restraints on the issues of currency.

Whether this inflation was necessary or desirable, either politically or economically, involves another series of questions too large for this paper. There is, for example, the question of loans and taxes. As arising out of the present argument, it is clear that loans, which are based on credit, before they can be effectively used or expended internally they must be pulverised into common currency. We were often told before the war that 90 per cent. of the value of coal was wages. The Census of Production has given us full evidence of the universal importance of the wages bill. The Government may pay its contractors by cheque, they again may pay their sub-contractors and all the business people they employ also by cheque, but in the last resort somebody has to pay all the wages bills in cash.

Conclusion

In conclusion, the broad results may be stated in the simplest form. There has been an abnormal growth in the various kinds of currency as compared with the pre-war rates of increase.

There has been also an abnormal rise in the prices of all the groups of commodities used for index numbers. The aggregate index numbers have doubled. There has been a similar abnormal rise in money wages.

In order of time the abnormal increase of currency preceded the abnormal rise in prices and in wages. The period of incubation lasted about five months, and, at any rate, for the first two years of the war, the rise in prices lagged behind the increase of currency.

The root cause of the inflation of the currency has no doubt been the great expansion of Governmental credit, which has only been made effective by being pulverised into the varied forms of currency required for different purposes. The growth of bank deposits does not mean increased savings but increased credit advances. The necessary proportion of cash for wages and retail trade, etc., is provided by notes and silver.

It is not convenient in a statistical paper to point the moral as if it were a sermon. Perhaps, however, it may be said without prejudice or offence that even in war time the same causes are likely to produce the same effects. If the inflation of the currency continues, the rise of prices will also continue.

Appendix.

Table showing in quarters of years 1914–17 : I. *Currency notes outstanding ;* II. "*Economist*" *index numbers ;* III. "*Statist*" *index numbers ;* IV. *Differences in* "*Economist*" *numbers ;* V. *Differences in currency outstanding ;* VI. *Differences in* "*Statist*" *numbers ;* VII. *Mean of index numbers differences.*

Quarters of Year.		I. Currency Notes Outstanding.	II. *Economist* Index Numbers.	III. *Statist* Index Numbers.	Differences. IV. *Economist.*	V. Currency.	VI. *Statist.*	VII. Mean of *Statist* and *Economist.*
1914	I	..	118·0	83·4	..	..	..	..
	II	..	115·9	82·0	—2·1	..	—1·4	—1·8
Five months of war	III	28·4	120·4	88·1	10·5	28·4	+6·1	8·3
	IV	38·5	127·3	90·1	0·9	10·1	2·1	1·5
1915	I	39·8	150·2	100·3	22·9	1·3	10·2	16·6
	II	46·6	147·7	106·5	—2·5	6·8	6·2	1·9
	III	72·0	151·6	107·1	3·9	25·4	0·6	2·3
	IV	103·1	165·1	113·8	13·5	31·1	6·7	10·1
1916	I	106·7	182·4	127·0	17·3	3·6	13·2	15·3
	II	122·0	191·5	133·3	9·1	16·7	6·3	7·7
	III	131·5	201·0	133·1	9·5	9·5	—0·2	4·7
	IV	150·1	222·0	148·8	21·0	18·6	15·7	18·4
1917	I	144·6	240·9	168·4	18·9	—5·5	19·6	19·3

Net Issues of Imperial Silver Coin in the United Kingdom during the War.

Period.	New Silver Issued.	Worn Silver Withdrawn.	Net Issues.
	£	£	£
August and September, 1914 ..	2,395,074	36,800	2,358,274
December quarter, 1914 ..	2,996,950	27,325	2,969,625
March „ 1915 ..	1,536,913	40,000	1,496,913
June „ „ ..	312,975	27,332	284,743
September „ „ ..	1,125,200	37,000	1,088,200
December „ „ ..	4,240,910	14,145	4,226,765
March „ 1916 ..	2,394,841	13,000	2,381,841
June „ „ ..	2,190,050	30,000	2,160,050
September „ „ ..	1,530,800	34,400	1,507,400
December „ „	1,302,600	39,795	1,262,805
March „ 1917	1,199,407	29,900	1,169,507
Total	21,232,820	326,697	20,906,123

Net Issues of Imperial Bronze Coin in the United Kingdom during the War.

Period.	New Coin Issued.	Worn Coin Withdrawn.	Net Issues.
	£	£	£
August and September, 1914 ..	42,510	1,073	41,437
December quarter, 1914	91,875	1,440	90,435
March „ 1915	53,955	1,400	52,555
June „ „	35,855	1,452	34,403
September „ „	93,615	1,260	92,355
December „ „	57,175	845	56,330
March „ 1916	117,880	858	117,022
June „ „	45,110	818	44,292
September „ „	117,975	605	117,370
December „ „	161,330	610	160,720
March „ 1917	145,240	551	144,689
Total	962,520	10,912	951,608

New Silver Coin Issued and Worn Silver Coin Withdrawn from Circulation in the United Kingdom from 1872–1914 and Index Numbers of Money Wages.

Year.	New Coin Issued.*	Worn Coin Withdrawn.	Net Issue.	Index Numbers of Money Wages.	
				Board of Trade.	Mr. G. H. Wood's Figures.
	£	£	£		
1871	..	..	..	..	77
1872	1,152,000	106,510	1,045,490	..	82
1873	734,500	168,263	566,237	..	87
1874	505,000	151,300	353,700	..	87
1875	598,550	154,000	444,550	..	86
1876	107,300	275,000	— 167,700	..	84
1877	290,300	207,280	83,020	..	84
1878	412,700	398,135	14,565	..	83
1879	283,430	456,200	— 172,770	..	82
1880	386,200	399,390	— 13,190	83·1	82
1881	570,000	340,286	229,714	84·6	82
1882	157,900	44,750	113,150	85·8	82
1883	969,100	348,770	620,330	85·7	83
1884	506,900	183,000	323,900	85·0	84
1885	342,100	249,998	92,102	83·7	83
1886	294,000	151,000	143,000	83·0	83
1887	656,040	330,670	325,370	83·1	83
1888	490,425	226,000	264,425	84·9	84
1889	1,791,000	213,000	1,578,000	87·7	87
1890	1,330,000	269,700	1,060,300	90·5	91
1891	749,000	195,400	553,600	91·6	91
1892	737,750	217,525	520,225	90·2	91
1893	777,100	276,000	501,100	90·3	91
1894	707,400	374,145	333,255	89·6	91
1895	819,000	432,940	386,660	89·3	91
1896	868,000	209,903	658,097	90·2	91
1897	721,700	338,200	283,500	91·1	93
1898	716,700	346,097	370,603	93·4	94
1899	755,500	386,499	369,301	95·6	96
1900	918,600	325,700	592,900	100·0	100
1901	331,750	220,590	111,160	99·0	98
1902	248,115	390,195	— 142,080	97·8	..
1903	127,000	260,000	— 133,000	97·3	..
1904	193,300	630,388	— 437,088	96·8	..
1905	223,000	436,000	— 213,000	97·3	..
1906	805,200	623,016	182,084	98·7	..
1907	888,325	709,700	178,625	102·1	..
1908	422,880	261,613	126,267	101·5	..
1909	655,099	717,590	— 62,491	100·3	..
1910	1,119,951	529,839	589,752	100·7	..
1911	1,219,766	547,675	672,091	100·9	..
1912	1,750,828	496,890	1,253,938	103·4	..

* Exclusive of Maundy money.

New Silver Coin Issued and Worn Silver Coin Withdrawn—Contd.

Year.	New Coin Issued.*	Worn Coin Withdrawn.	Net Issue.	Index Numbers of Money Wages.	
				Board of Trade.	Mr. G. H. Wood's Figures.
	£	£	£		
1913.. ..	1,523,979	541,695	982,284	106·5†	..
1914.. ..	6,092,569	452,125	5,640,444	..	..
1915.. ..	..	..	..	..	..
1916.. ..	..	..	..	..	..
Total ..	34,950,097	14,592,677	20,357,420	..	..

* Exclusive of Maundy money.

		£	
†1915.	Net issue of silver	7,096,621	
1916.	,, ,, ...	7,312,096	
1914.	Wages	107	Estimated.‡
1915.	,, ...	117	
1916.	,, ...	137	

‡ Mr. Kitchin writes: "I estimate the Board of Trade Course of Wages (if still published) would show 106·5, 107, 117, and 126 for 1913, 1914, 1915, and 1916."

Returns relating to the Imperial Bronze Currency.

TABLE A.—*Issues of Bronze Coin to December 31, 1914.*

Denomination.	Bronze Coin Issued in 1914.	Bronze Coin Issued from December 17, 1860, to December 31, 1914.				
		1860 Design.	1895 Design.	1902 Design.	1911 Design.	Total.
	£	£	£	£	£	£
Pence ..	212,759	1,493,490	[illegible]5,312	1,021,013	853,163	3,972,978
Halfpence	42,265	626,270	[illegible]	222,790	149,109	1,136,856
Farthings	6,110	127,953	33,81[illegible]	45,429	23,743	230,935
Total ..	261,134	2,247,713	777,809	1,289,232	1,026,015	5,340,769

TABLE B.—*Imperial Bronze Coin Issued Annually from 1900–1914 Inclusive.*

Year.	Bronze Coin Issued.				Distribution of Bronze Coin Issued.		
	Pence.	Half-pence.	Far-things.	Total.	London.	Rest of the United Kingdom.	Colonies, Treasury Chests, etc.
	£	£	£	£	£	£	£
1900 ..	133,385	28,930	5,980	168,295	37,350	118,740	12,205
1901 ..	89,100	23,785	7,395	120,280	26,405	79,090	14,785
1902 ..	114,317	27,767	6,315	148,399	28,784	108,675	10,940*
1903 ..	85,480	24,155	4,260	113,895	14,365	83,175	16,355
1904 ..	56,495	16,465	4,935	77,895	12,875	57,935	7,085
1905 ..	76,920	19,285	4,120	100,325	15,450	79,360	5,515
1906 ..	154,365	25,330	4,825	184,520	43,110	127,340	14,070
1907 ..	188,885	34,070	4,595	227,550	55,185	145,050	27,315
1908 ..	126,440	24,260	4,880	155,580	46,055	92,080	17,445
1909 ..	88,567	25,964	7,280	121,811	30,869	71,532	19,410
1910 ..	121,970	24,530	4,952	151,452	38,025	85,032	28,395
1911 ..	107,750	26,755	5,800	140,305	28,680	106,710	4,915
1912 ..	271,780	44,125	7,330	323,235	84,810	224,105	14,320
1913 ..	272,925	36,630	4,970	314,525	92,475	213,875	8,175*
1914 ..	212,759	42,265	6,110	261,134	68,314	188,920	3,900
Total.	2,100,838	424,616	83,747	2,609,201	622,752	1,781,619	204,830
Annual average	140,056	28,308	5,583	173,947	41,517	118,775	13,655

* Exclusive of £100 in one-third farthings issued to Malta.

TABLE C.—*Imperial Worn Bronze Coin Withdrawn from Circulation.*

Year.	United Kingdom.			Colonies.			Total.		
	Pence.	Half-pence.	Total.	Pence.	Half-pence.	Total.	Pence.	Half-pence.	Total.
	£	£	£	£	£	£	£	£	£
1908	4,471	789	5,260	160	40	200	4,631	829	5,460
1909	17,483	2,792	20,275	505	95	600	17,988	2,887	20,875
1910	18,697	2,477	21,174	883	376	1,259	19,580	2,853	22,433
1911	17,151	2,534	19,685	408	392	800	17,559	2,926	20,485
1912	13,096	2,118	15,214	398	94	492	13,494	2,212	15,706
1913	11,877	1,816	13,693	77	13	90	11,954	1,829	13,783
1914	8,277	1,391	9,668	151	44	195	8,428	1,435	9,863
Total	91,052	13,917	104,969	2,582	1,054	3,636	93,634	14,971	108,605

TABLE D.—*Wholesale Prices, Index Numbers, and Currency Note Circulation.*

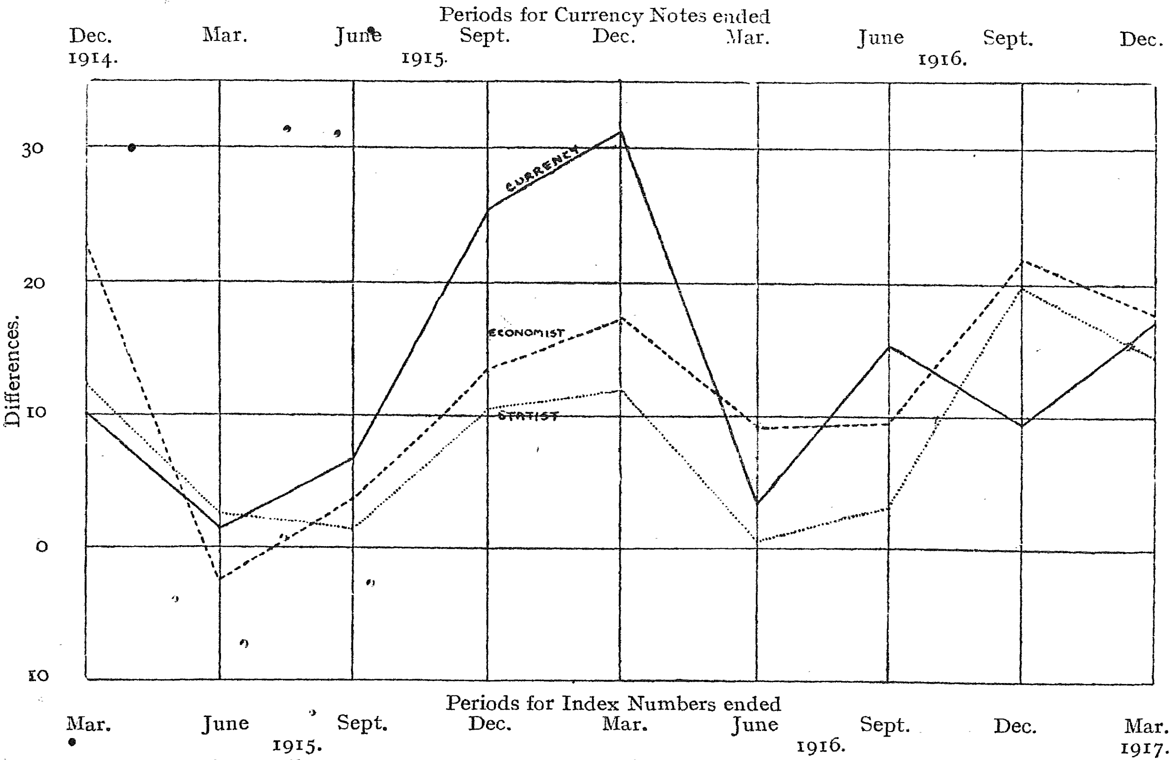
Dates.		*Economist* Index Numbers.			Quarterly Average.
1914.	Aug., Sept.	122·6	126·4		125
	Oct., Nov., Dec. ..	124·2	125·5	127·3	126
1915.	Jan., Feb., Mar. ..	136·5	142·3	150·2	143
	Apr., May, June ..	151·2	151·2	147·7	150
	July, Aug., Sept. ..	149·1	149·8	151·6	150
	Oct., Nov., Dec. ..	153·2	159·1	165·1	159
1916.	Jan., Feb., Mar. ..	174·5	182·2	182·4	180
	April, May, June ..	190·5	196·3	191·5	193
	July, Aug., Sept. ..	191·1	198·7	201·0	197
	Oct., Nov., Dec. ..	208·7	217·2	223·0	216
1917.	Jan., Feb., Mar. ..	225·1	230·5	240·9	232
	April, May, June ..	244·5	246·0	—	—

Dates.		*Statist* Index Numbers.			Quarterly Average.
1914.	Aug., Sept.	87·9	89·3		89
	Oct., Nov., Dec. ..	89·8	88·8	91·6	90
1915.	Jan., Feb., Mar. ..	96·4	100·9	103·7	100
	April, May, June ..	105·9	107·2	106·4	107
	July, Aug., Sept. ..	106·4	107·0	107·8	107
	Oct., Nov., Dec. ..	110·0	113·1	118·4	114
1916.	Jan., Feb., Mar. ..	123·6	127·0	130·4	127
	April, May, June ..	134·2	135·4	131·0	134
	July, Aug., Sept. ..	130·5	134·5	134·4	133
	Oct., Nov., Dec. ..	141·5	150·8	154·3	149
1917.	Jan., Feb., Mar. ..	159·3	164·0	169·0	164
	April, May, June ..	173·0	174·0	—	—

Dates.		Currency Notes (millions).			Average.	Quarterly Averages.		
						Economist Index Averages.	*Statist* Index Averages.	Currency Notes with three months' lag.
1914.	Aug., Sept. ..	25·2	28·4		27	125	89	35
	Oct., Nov., Dec.	31·4	34·5	38·5	35	126	90	37
1915.	Jan., Feb., Mar.	35·8	36·7	39·8	37	143	100	45
	April, May, June	42·1	45·7	46·6	45	150	107	58
	July, Aug., Sept.	45·4	57·7	72·0	58	150	107	93
	Oct., Nov., Dec.	84·9	91·9	103·1	93	159	114	102
1916.	Jan., Feb., Mar.	89·8	100·9	106·7	102	180	127	119
	April, May, June	117·2	118·6	122·1	119	193	134	129
	July, Aug., Sept.	127·6	129·6	131·5	129	197	133	141
	Oct., Nov., Dec.	137·2	136·6	148·8	141	216	149	144
1917.	Jan., Feb., Mar.	143·6	144·4	144·7	144	232	164	—
	April, May, June	154·4	159·1	—	—	—	—	—

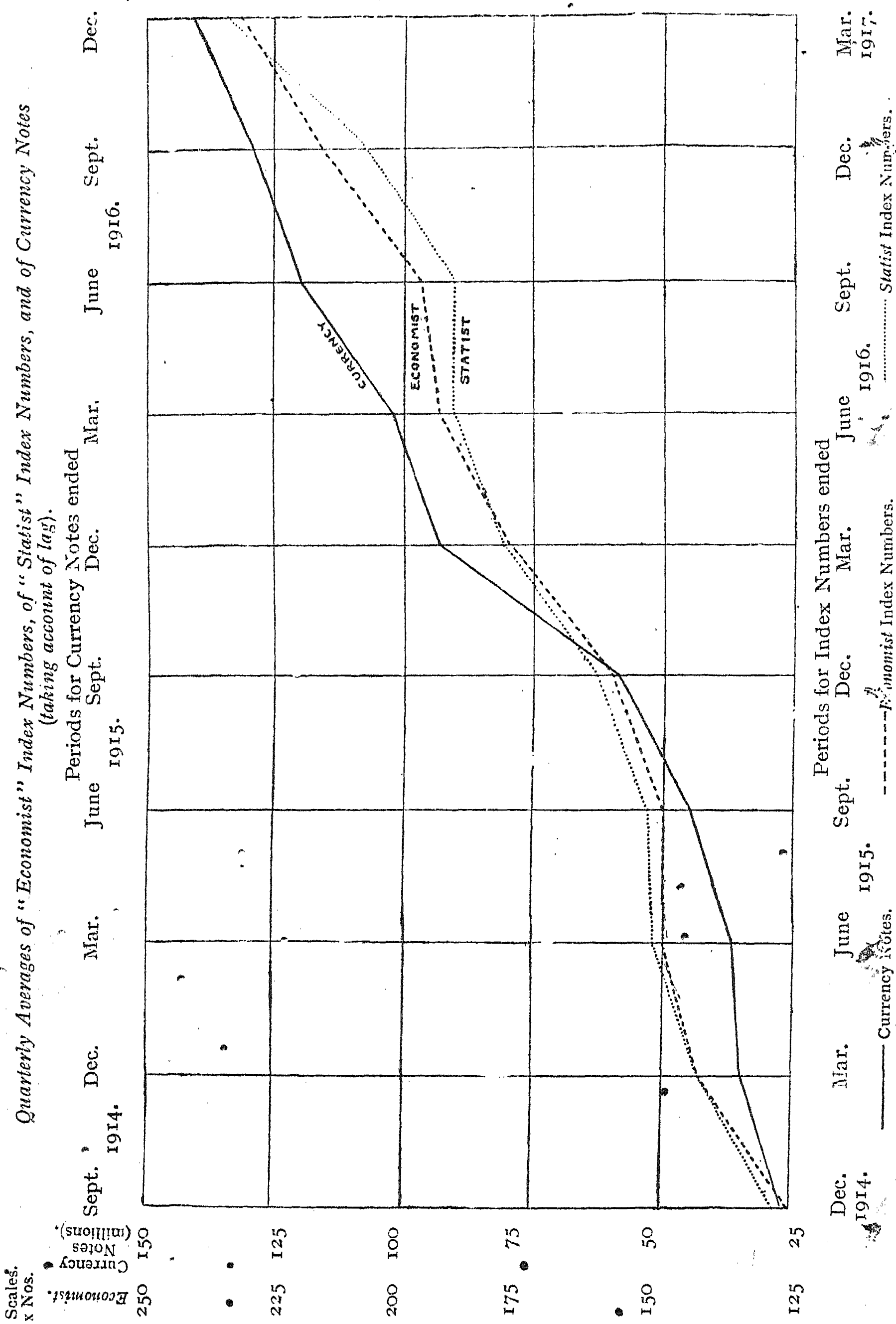
[NOTE.—The currency note values are taken at the date that is nearest to the end of a month and include currency certificates outstanding.]

"Economist" Index Number Differences, "Statist" Index Number Differences and Currency Note Differences, with a Quarter's Lag for Index Numbers.



——— Currency Notes. - - - - - *Economist* Index Numbers. ········ *Statist* Index Numbers.

Note.—In the construction of the curves I am indebted to Dr. Carse, Lecturer in Statistics and Mathematical Economics, Edinburgh University.



Quarterly Averages of "Economist" Index Numbers, of "Statist" Index Numbers, and of Currency Notes (taking account of lag).

CHAPTER VI

A CHAPTER IN THE LIFE OF JOHN LAW *

Un Capitolo della Vita di Giovanni Law. Da documenti inediti. Memoria di Giuseppe Prato. (Torino : Fratelli Bocca, 1914.)

PREFATORY NOTE

[HITHERTO the most celebrated inflationist in history has been John Law—a financial genius of the first rank, who anticipated two centuries ago the most modern ideas of banking and credit, but against his own principles gave way to inflation in his *System*. For a time he was in power and reputation the greatest man in Europe. The man and his works are worthy of special consideration in the present age of inflation.]

This is not the place or the occasion to enter on the general question of the neglect of Italian literature since the middle of last century, when the German boom became marked. On the plain question of fact there can be no doubt that at present, as compared with the first quarter of last century, in this country the study of German and Italian have changed places. In the former period every well-educated person was supposed to know Italian as now he is supposed to know German. "That laborious people," as Adam Smith called the Germans, no doubt have their merits, but after all "Hermann's a German," and has his defects.

Italian works that attain a certain popularity may no doubt be read in French or English translations, but many

* First published in the *Economic Journal*, September, 1915.

valuable studies will not bear the cost of translation into another tongue.

These reflections were caused by the perusal of a study by Professor Prato, reprinted from the *Transactions of the Royal Academy of Sciences of Turin*. This memoir on John Law, although written purely as a study in economic history, is opportune in calling attention to certain fundamental monetary principles which seem to be in danger of being overlooked in the present war even in this country.

Altogether apart from the suggested application (about which there may be some difference of opinion) *A Chapter in the Life of John Law* is an excellent piece of work. As Professor Prato observes by way of introduction, there was shown in the character and actions of John Law a marked contrast of qualities. The man and his system (*the* System as it used to be called) can only be understood and appreciated when account is taken of this contrast, or series of contrasts, in the life of its maker. The life of John Law was a romance of that order of magnificence and dramatic action that appealed to the imagination of Alexander Dumas. John Law was born in Edinburgh in 1671, of good family on both sides. His father, a goldsmith (something of the old George Heriot kind of banker), amassed a large fortune and acquired a considerable landed estate—Lauriston, near Edinburgh. He died when his son was only fourteen and left him his wealth and the estate, from which he is always spoken of as John Law of Lauriston. At the age of twenty-three John Law killed his man in a duel, for which he was sentenced to death but pardoned by the Crown.

Steps were taken to upset the pardon by the family of the dead man, and John Law found it convenient to bribe his keepers (he had again been thrown into gaol) and flee to Holland. This was in the year of the foundation of the Bank of England (1694). He was appointed Secretary to the British Resident and some time after married a daughter of the Earl of Banbury. These facts are recalled to show that John Law was by no means a needy adventurer, but from his youth a man of substance and a man of fashion. In an

age of gamblers he was also a prince of gamblers, accustomed to play for very high stakes and to keep his head. From his gambling he gained a first-hand practical knowledge of the theory of probability that is the foundation of modern banking. In Holland he became familiar with the primitive system of the Bank of Amsterdam, which in its origin preferred the method of certainty to the method of probability. John Law was much struck by the benefits conferred on Holland by its banking system. He compared Scotland and England with Holland and found that in all the usual elements of economic strength Holland was inferior, and yet in the accomplished fact of accumulated wealth greatly superior. This difference was accounted for first of all by the banking system. The Dutch had discovered the proper use of paper money and the superiority of paper to metallic currency. On this point John Law was as keen as the latest advocate of the gold-exchange standard. The second basis of the economic prosperity of Holland he found in the fact that Holland knew better than any other country the art of government, including the art of non-government. In Holland trade and industry were allowed much more freedom for development than in Britain.

Such were the elements that came to the making of John Law's great System: a first-hand knowledge of banking and trade as practised in the richest country in Europe, and a first-hand knowledge of gambling and speculation as practised amongst people of fashion.

John Law returned to Scotland when about thirty and tried his 'prentice hand in his own country by publishing a proposal for a Council of Trade, based on the Dutch example, with his own improvements. This scheme was, however, too magnificent for the Scotch, and about five years later he published his notable work on "Money and Trade," with the view of promoting a less ambitious scheme, the leading idea in which was the issue of bank-notes based on landed security. This scheme was also found too advanced for his native country, and John Law resumed his old life on the Continent. He gambled his way through Europe, indulging

in all kinds of speculation, and making a special study of the conditions of banking and finance in all the capitals he visited. In his gambling, in the narrow sense, he played for such high stakes that he used counters to represent the gold in the heavy money bags which he took with him to the tables. As the result of these transactions John Law gained a large fortune, and was well known in many of the Courts of Europe.

In the course of his wanderings John Law came to the Court of Vittorio Amedeo II. in Turin and propounded for the benefit of this Prince a project for a bank. This is the chapter of his life (1711–12) that is the subject of the monograph under review. Professor Prato has brought to light some documents bearing on this project which are of the first importance in tracing the development of the System and also in throwing light on the character of the man. Some of the John Law documents from the Turin Archives had been published by Domenico Perrero as far back as 1874, but by an oversight he had omitted to take account of the most important. It is these documents which are now brought to notice in the learned monograph of Professor Prato.

It is impossible in this place to do more than indicate the chief results, but before doing so reference may be made to the popular opinions on John Law that are still current in the usual accounts of the System. This persistence in the popular errors concerning John Law is easily explained. The System, as actually developed in France in connection with the Bank and the Mississippi scheme, gave rise (1720-21) to the greatest speculative mania on record. For a time France lived in what seemed to be a golden age of prosperity —a veritable orgy of paper money and peace bonuses. Not only was there a nominal increase in the fortunes of individuals, but all over the country, under the stimulus of the new money, there was a great outburst of industrial activity. At the same time as John Law became the most powerful man in France (and perhaps in Europe) he used his power for the improvement of taxation and administration, applying the ideas he had learned in Holland. Of the actual

prosperity of France during the first stages of the inflation there can be no doubt.

Unfortunately, though in the first beginnings (1716) the finance of the System was on a sound basis, it soon degenerated, and in its final stages the issues of paper money were in such excess that after the catastrophe the notes became quite valueless. After a time of the most buoyant delusive prosperity France was plunged in the depths of depression. No terms were too hard for John Law, and it was readily believed that from the beginning he had been an unscrupulous adventurer only bent on his own interests. The most favourable view taken was that he did not understand the difference between real money and paper, and that he laboured under the delusion that an increase of money meant an increase of wealth, and that paper money was better for the purpose than metallic money. In fact, John Law was supposed to have believed that an abundance of paper money was the secret of national wealth. It is true that soon after the catastrophe attempts were made to justify John Law, but they were swept away by the virulent invective of Duvernay.* Unfortunately, Adam Smith accepted this version without any reference to the original evidence. "The different operations of this scheme (*i.e.*, the Mississippi) are explained so fully, so clearly, and with so much order and distinctness by Mr. Du Vernay, in his examinations of the political reflections upon the commerce and finance of Mr. Du Tot, that I shall not give any account of them" ("Wealth of Nations," bk. ii., chap. ii.). Adam Smith goes on to speak of the splendid but visionary ideas set forth in John Law's writings, and visionary if not splendid they have been considered ever since in the popular text-books.

In his excellent introduction Professor Prato gives a critical account of the vast literature which has grown up round John Law and his schemes. The nineteenth century saw some notable cases of a revulsion in his favour by

* As Professor Prato shows, the brothers Duvernay had been deprived of their lucrative offices by John Law in his financial reforms.

competent investigators and enthusiasts. The social effects of the disaster of 1721 were glorified by Louis Blanc and Proudhon, because in the end the people gained at the expense of the parasitical classes. Michelet noticed the enlargement of ideas induced by John Law's industrial and colonial schemes, and praised his love of humanity and of the working classes, and looked upon him as the forerunner of the Republic.

But in spite of these and other defenders John Law is still generally looked upon as the typical inflationist, who was ignorant of the elements of sound banking.

The documents now brought to light by Professor Prato dispose for ever of the myth of the ingorance of John Law. They show conclusively that he submitted to the Prince of Piedmont a scheme for a bank which in its final form was of the soundest and simplest order. It was specially sound as regards the convertibility of the notes. In the first scheme (1711) a provision had been inserted providing that in case any note was not cashed on demand, then all the notes, whether presented or not, should bear interest at 8 per cent. This was a method of deferred or suspended convertibility which was later adopted in Scotland with lamentable results. In the final scheme, however (1712), the specie held against the notes was to amount to no less than 75 per cent.

In support of his schemes for establishing a bank in Turin John Law submitted reasoned memoirs on the nature of money and credit with important historical instances. In these documents passages are reproduced *verbatim* from his former writings, but there are several new ideas and facts. In one document an interesting account is given of the failure in France in 1707 of a system of notes which had been issued without proper provisions for convertibility.

There can be no doubt whatever that John Law, at the time of his banking projects in Turin, had a thorough knowledge of the real meaning of convertibility of notes, and had tested the theory by well-known instances, positive and negative.

He believed, no doubt, that paper money was better than metallic money—and not only as a medium of exchange. In particular, influenced by the origin of the Bank of Amsterdam, he showed that paper money might be more stable in value than the actual circulating currency.

The interesting question remains: If John Law knew so well what was right, why did he consent to the abandonment of all his principles in the great inflation of his Paris bank? If John Law was a sound economist, what about the soundness of his morality?

Professor Prato has done me the honour of referring in most appreciative terms to my study of John Law published in 1888.* One can read an essay nearly thirty years old with the *sangfroid* of the impartial spectator. I am still of opinion that John Law was more sinned against than sinning. He was rushed along too quickly by the greedy, ignorant, unscrupulous Regent. He believed in his System, and no doubt he thought that given time the storm might be weathered. With the greatest courage he stayed on in Paris to the end, and he left there the whole of his great private fortune. Professor Prato brings out very clearly the fact that there were combined in John Law at least two different characters, who led different lives. There is John Law the writer, a man of mark in the development of monetary theory. There is John Law, the practical man of affairs, who tried to persuade first his own country and then others to put in practice his theory of credit. His scheme offered to Turin was in effect, as Professor Prato shows, the same as the scheme of his Paris bank on its foundation. Had John Law the banker rigidly confined his bank within these limits and restrained the too rapid growth of his vast colonial schemes, no doubt he would now rank as the greatest financier of history. But the other John Law was a gambler, and as a gambler he took chances which ought never to have been taken by John Law the banker and *de facto* ruler of France.

* "Money and Monetary Problems," pp. 165 *et seq.*

CHAPTER VII

FRIEDRICH LIST: THE PROPHET OF THE NEW GERMANY *

Friedrich List als Prophet des neuen Deutschland. By KARL KUMPMANN. (Tübingen: J. C. B. Mohr (Paul Siebeck.) 1915. Pp. iii + 52.

PREFATORY NOTE

[THE influence of List on German economic ideals and practice is also discussed in the articles on Germany's Economic Miscalculations (see below, pp. 187, 194).]

"A prophet is not without honour, but in his own country, and among his own kin, and in his own house" (Mark vi. 4) would have been a good text for Dr. Kumpmann's sermon, had not the fashion for quoting Scripture gone out in Germany in these latter days. In a bibliographical note at the end of his pamphlet the author remarks that the List literature is amazingly poor, and (we might add) especially considering the vast amount of labour spent by German writers on economists many classes below List in reputation. His friend, Ludwig Häusser, published (1850–51) his principal works in three volumes with Life, but the promised supplement of the smaller works of List never materialised. An occasional essay in an economic journal or dictionary and a place in histories of political economy only served to show how little the prophet was honoured in his own Fatherland. There is no work, says Dr. Kumpmann, which does justice to the higher claims of List. "The best critical estimate of his work is by the

* First published in the *Economic Journal*, March, 1916

Frenchman, Rist" (in the "History of Economic Doctrines," by Gide and Rist). Dr. Kumpmann does not refer to the appreciation of the work of List in America and in England, though the excellent work of Miss Margaret Hirst ("Life of List, with Selections from his Writings") ought to have appealed to him if only for the very full bibliography.

Dr. Kumpmann himself has no doubt regarding the greatness of his prophet. In the very first sentence he declares that Friedrich List is the most important political economist that Germany has produced, and in the last sentence he expresses the fervent hope that his study may help to call attention to the great master. List showed real original power of the first order on two sides. In the first place, he put in proper perspective the importance of the *mental capital of the race* as contrasted with the accumulation of material values. The following sentence is one of his key-positions and is of special interest at the present time :—"*The power of producing wealth* is therefore infinitely more important than *wealth itself;* it ensures not only the possession of what has been gained, but also the replacement of what has been lost." What is the organisation of which we now hear so much as the foundation of Germany's strength but a striking illustration of this foundational idea of List? It is from this standpoint that List treated the controversy between Protection and Free Trade. According to List, neither system is an end in itself, but simply a means to achieve a certain end, namely, the greatest development of productive power. Protective duties were only justifiable as educative taxes. It is this part of the teaching of List which has attracted most attention in English-speaking countries, partly owing to the similarity of the thought to that developed by Henry Carey.*

It is, however, to another side of the genius of List that Dr. Kumpmann has devoted his inquiry. List was not

* The present reviewer has dealt mainly with this side of List's writings in the introductory essay to the new edition of Lloyd's translation of the "National System" (Longmans, 1904). *Cf.* also "The Neutrality of the United States" (1915), ch. iv., on the Commercial Policy of Germany) on List's wider views on the expansion of Germany.

only an economist, but a political economist, and the principal application that he made of his economic principles was to the case of the development of Greater Germany. Of this development he was the great prophet and, up to a point, the true prophet. The keenness of his vision can only be realised by calling to mind the old Germany of the many states and the many tax systems, and comparing with it the Germany of July, 1914. It was in 1819 that List adumbrated his scheme for a Zollverein between the various German taxing powers. At that time Prussia alone had within its boundaries sixty-seven tariffs, levied according to districts, some on persons and some on things. Taxes on 2,775 articles were collected by an army of 8,000 officials.* The other states and cities were equally afflicted. No wonder that in those days List was a Free Trader. The wonder is that he did not regard as Utopian the establishment of internal Free Trade in Germany—as Adam Smith himself looked on the like case in England.

But the internal economic development of Germany was only the beginning of the vision. List set up a political programme which was partly realised by Bismarck—the practical statesman, as Dr. Kumpmann observes, who was the fulfiller of so much of List's ideal. At the same time, we must recognise that with List the internal and the external development of Germany were inseparably joined together.

In the far-off days before the war it was always an unexpected pleasure to find a German work in which clearness, proportion, and, above all, brevity were preferred to their opposites. Perhaps the highest praise we can offer to Dr. Kumpmann is that his pamphlet might have been thought out and written in French, such are its merits—such is its freedom from the besetting faults of his countrymen. In a note of apology at the end he simply says that he has given no references, but that the reader will easily find the significant passages in the index to Häusser! It is to be hoped so excellent an introduction without incumbrances to the real List may be translated into English.

* "Life of List," by Miss Hirst, p. 11.

The first section of the pamphlet declares in no uncertain voice that List was a political thinker of the first rank born before his time—a prophet who knew that he was writing and agitating for the future. His ideas were so large that at first he was looked on merely as the maker of the project of an Empire, until the war of 1870–71 showed that the project was in process of becoming a reality.

In a few lines a contrast is drawn between the old Germany into which List was born and the new Germany of which he was the forerunner. List was the great path-breaker in two directions which vitally affected the internal development of Germany. His scheme (1819) for a Zollverein became a reality in 1834, and the next year is given as the date of the beginnings of the German railway system. List looked on the construction of railways and the furtherance of internal free trade as parts of the same economic policy. The Zollverein and railways have made modern Germany, and in both the chief builder was List.

In the second section are brought out the leading ideas of List's economic system. It is admitted that in his zeal for the exposure of the fallacies of "the school" he failed to distinguish between the real Adam Smith and the scholars who had reduced the teachings of the master to a few simple dogmas. As the present writer has shown elsewhere, most of the criticism of List as applied to the real Adam Smith is irrelevant. But even to-day, how many English people know more of the real Adam Smith than is contained in his saying that defence is of more importance than opulence? List, however, did not know or remember that Adam Smith had made this utterance. He looked on Adam Smith as a cosmopolitan, and he set up against him the National System of Political Economy. Nationality was the first ground-thought of the new master. The second was the displacement of material capital ("fast-frozen labour-time," as the German Socialists came to call it) by living productive labour as the chief requisite of national power. Again, List forgot, if he ever knew, all that Adam Smith had written of the living instrument as compared with the

dead machine. But the attack of List on "the school" was just and opportune, and his teaching was as much needed in England as in Germany. In the former country there were philosophers who looked for the natural disintegration of the British Empire, just as in the latter there were philosophers who could not imagine the integration of the German Empire. The nationality that List had in view was of the kind that has since come to be called Pan-German. The German race, in his opinion, was eminently fitted by its natural qualities—a large number are enumerated, including a great fund of "natural morality"—for entering the front rank as a world-power in the economic sense.

In the third section the internal economic policy of List is sketched in "a couple of sentences because to-day it is common ground for all political parties in Germany." And the first requisite—strange as it may seem to us—is, of all things, more freedom, and freedom in our English sense of the term, freedom of thought, freedom of the Press, freedom *from* the Government, etc., "for without freedom there is no true Kultur—no well-founded polity." Here it may be observed that List himself was an ardent admirer of the British constitution (notably, by the way, of trial by jury), and he looked forward to the growth of a German constitution on similar lines.

The fourth section ostensibly deals with the Zollverein and the political unification of Germany, but always with the understanding that United Germany is to take her proper place amongst the nations. Internal union is only the first step to the assertion of German national power in the outer world. The prophet, in spite of his long residence in the United States of America, never thought of Germany as a republic, nor, on the other hand, as a despotism of the Russian kind—a constitutional monarchy was his ideal, but [unfortunately], as he showed, this new birth of Germany was only to be expected from Prussia. The Prussian part of the prophecy was true enough, but in the meantime German constitutional freedom became an example of *lucus a non.*

The fifth and sixth sections, which deal with the ideas of List on Germany as a world-power, are of the greatest interest at the present time; but on so large a subject it is impossible to attempt further condensation than is effected by Dr. Kumpmann.

The ground-thoughts are three, and the first is the development of the consular service. How much of the growth of German foreign trade has been due to the consular service we are only just beginning to realise. We are just beginning to learn that, even in war-time when we rule the seas, the capture of German trade means a far more effective consular service. One of the most important functions assigned by List to the consuls was to direct the stream of emigration from Germany, and the management of what we now call the peaceful penetration of every continent. His second ground-thought was precisely this peaceful penetration. Incidentally, List does not approve of the principal emigration of Germans being to the United States. The absorbing power of the States is too effective. "There is not a German in the States whose grandson does not far prefer the English language to the German." The third requisite for German world-power is a great fleet. This is a text that needs no comment.

One of the most interesting parts of the work of List, and also of his latest expositor, is the consideration of the relations of Germany to other world-powers. List looked on France and Russia as the natural enemies of Germany—France on account of her restless militarism, and Russia through her instinctive striving for expansion. In fact, List saw in France and Russia separately what we now think we see combined in Germany.

In the vision of List, as in the history of which it is a reflex, it is always England that plays the chief part. England, he thought, had gained the commercial supremacy of the world by that monopoly which Adam Smith called the great engine of the Mercantile System. England was ready to throw away the ladder of Protection when she no longer needed it, but she did not mean other nations to

follow in her steps. Universal Free Trade had become the English ideal only because at the stage she had reached it best suited her interests. List maintained that the other nations, and notably Germany, must follow the path of Protection until they were strong enough to roam at large under Free Trade. So far, German interests were economically opposed to those of England. England was looked on as always striving to keep down a rising rival. This idea of English policy is still dominant in Germany, and is the main reason why the Germans think we manœuvred to encircle them with hostile warring nations.

But List the prophet looked to a more distant future. In the last scene of his vision he sees Germany and England as allies in world expansion. Germany will assume the protectorate of Turkey, but will thereby act as guardian of British communications with the East. The south-eastern expansion of Germany was not approved by Bismarck, but has been approved by the man who dropped Bismarck as pilot. At this point the vision of List—with our present outlook—soars into the unreal or the ideal. The last scene is a great confederation of all the European nations—a great United States of Europe—under the hegemony of England, England content to be an equal amongst equals. And for what end? What is to be the binding force of the union? The answer is startling, having regard to present conditions. The United States of Europe was to be founded and maintained to keep in check the United States of America. When, relatively to the gigantic American nation, England had become, so to speak, a little Holland, in her own interest she must strive to lead the United States of Europe against the Marinismus of America.

In his last days the idea of an alliance between England and Germany became the dominant thought with List. His last work was a tractate "On the Value and the Conditions of an Alliance between England and Germany." For the furtherance of this object he came to England, where he witnessed the final stages of the repeal of the Corn Laws, and saw face to face the leaders of English

politics. His project of an alliance was received coldly. The advantages seemed too far off to the practical imagination of the English statesmen. In the opinion of Dr. Kumpmann the chagrin caused by the failure of this cherished scheme was the immediate cause of the tragedy by which he put an end to his life. A fitting omen for the greater tragedy of to-day! "Back to List" is the moral which Dr. Kumpmann commends to his countrymen, but what a gulf must be bridged over before the passage can be made!

CHAPTER VIII

CENTRAL EUROPE AFTER THE WAR *

"Mitteleuropa." By FRIEDRICH NAUMANN. (Berlin: Georg Reimer, 1915. Pp. viii + 299.)

PREFATORY NOTE

[SINCE this review was written Herr Naumann's book has been translated into English, with an introduction by Sir W. J. Ashley. It has given rise to great discussions in Germany and all over the world.]

To be unprepared for peace is almost as dangerous as to be unprepared for war. With the British Empire it is perhaps even more dangerous. The extent of our Empire and of our sea-power and the strength of our alliances gave us time to put on our armour after the war had broken out. Once, however, effective negotiations for peace have begun they ought to be perfected as quickly as possible. Unless the nations concerned have made up their minds on the principles and limits of possible peace, the peace will be no better than a mere cessation of war by exhaustion—more like the peace of death than the peace of God. Even supposing that it is a fight to a finish, and that one side (our own side) is completely victorious, we cannot simply lay waste Central Europe and sow its lands with salt. We cannot even dictate terms of peace altogether regardless of the opinion and the hopes of our adversaries. The British Empire is by long tradition tolerant and generous. Its structure is as composite as that of the world itself, and its sympathies are in consequence world-wide. We desire to

* First published June, 1916, in the *Economic Journal*

fulfil the reasonable expectations of all other nations. Everything turns on what is reasonable in the circumstances. We want to know what are the real aims of our present enemies, and what, in the light of the present war, will be the main lines of their policy after the war. We want to look at the questions that must be answered before the great peace from all points of view, including that of our enemies. We must take account of the fact that the war itself, whatever the military results, must change many fundamental ideas of national policy. The inter-relations of the States of the British Empire will be different, so will the inter-relations of the Central European States. International policies must be modified by these changes in national policies.

In this work we are only concerned with economic policy, but the economic problems of the coming peace are of the kind and breadth that were discussed by Adam Smith, whose large ideas of future progress were always conditioned by "the circumstances of the society," by "the prejudices and the interests of the times," and other disturbing causes which lie beyond the domain of any pure theory of economics. Even J. S. Mill, the great exponent of the deductive method, was obliged to admit that in one great group of economic problems it was not possible to confine the attention to economical considerations alone. A similar breadth of view is desirable in discussing the economic problems of the coming peace. And such is the breadth of view in the work recently published by Herr Friedrich Naumann on Central Europe, a work which is said to have had a phenomenal success in Germany, and to be there regarded as *quasi*-semi-official in its suggestions of after-the-war policy.

Apart from any kind of hyphenated authority, the book provides, in a very convenient form, a conspectus of the facts and the circumstances, the opinions and the prejudices, of the principal enemy countries, such as they were before the war, such as they are in the war, and such as they are likely to be after the war. "Reading maketh a full man," and the repast offered in "Mitteleuropa" is a very filling repast.

But it is much more than a mere array of substantial facts. The success of the book in Germany is not in itself a guarantee of its success with the English reader. There have been since the war many successful books in Germany which, to recall a Dantesque expression, are worthy of silence. We have been so deluged in this country with extracts from prose versions of songs of hate and the like that at first sight the invitation to read through Herr Naumann's three hundred closely printed pages (in German character) in search of the reasonable expectations of the Germans does not seem very attractive. Be it said, then, at once that the work is quite different from the typical war literature of Germany. There is nothing in it from beginning to end--not even in tone or insinuation—that could give offence to any nationalist of any country. It is also quite different from the typical German work of peace-time. It is eminently readable. The learning and the labour are hidden away in the foundations or stored for reference in an appendix. The yle is lively and well garnished with similes and humour. The argument is genial and (from the German standpoint, sweetly reasonable, but by no means sickly sweet. There are some bitter home truths—for the Germans. The Utopian is eschewed. There is no dream of universal peace. On the contrary, the main trend of the argument is that wars must come in the future and that the first duty of the new Central Europe is to be prepared for war. The pleasing literary style should not delude the reader into supposing that the argument is not solid and well-balanced. It is, indeed, so solid and far-reaching that a short *résumé* is impossible. Instead of trying to outline the general treatment section by section, it seems more profitable to call attention to some of the foundational ideas and to some of the most significant results and proposals.

The book was planned, so the author tells us, in April of last year, when the Russians were being driven back from the Carpathians. Throughout it is implied that Germany will be victorious in the end, although the estimate of

victory is what in business circles would be called conservative. There may be some bending of the international boundaries on the East or the West, but the extent of the bending does not much affect the main argument. What would become of the main argument if Germany were defeated is not conjectured. Victory is relied on to get rid of minor jealousies and to smooth away national friction. As one result of the war there is to be a kind of blood brotherhood. *Mutatis mutandis*, it might be thought that defeat would lead to mutual recrimination and insistence on national interests, but that is another argument.

One of the most remarkable of the foundational ideas is that even if the Central Powers are completely victorious neither Germany nor Austria-Hungary can stand alone. "*Klein und allein*" will mean destruction to Germany whatever the result of the war. This is not the cry of the eagle that we have become familiar with. But there is no doubt about the contention. The possibility of various alliances with other Great Powers is discussed in the most detached way. France, Greater Britain, and Russia are all weighed, and all are found wanting as allies, though the two former are said to be in theory quite possible. A similar argument is applied to Austria-Hungary. Still less than Germany can the Dual Monarchy stand alone. Isolation means partition. Therefore for both Central Empires the absolutely necessary solution must be a combination closer than any ordinary alliance—closer even than that maintained during the war. Germany and Austria-Hungary must be bound together so as to attain the maximum of military power, and, as an essential foundation, the maximum of economic power. This close union of the two Empires is the necessary foundation of the new Central Europe. To begin with, it would be useless to try to gather in the other outlying nations which it is hoped in the future will be added to the new Great Power. The Northern nations and the Southern nations are for the present left out. First of all, the foundations must be well and truly laid before the full structure can be raised. The complete

designs of the architect are not wanting in grandeur. "Sometime" he hopes that both France and Italy will find that their destiny is Central-European. Belgium is not mentioned by name—Herr Naumann is a great master of the art of silence—and Bulgaria, Serbia, and Turkey are put on the general waiting list for future admission to the Central-European State. Eventually it would seem that Central Europe is to embrace all Europe that is not Russian. But to begin with the author insists that the Union must not extend beyond Germany and Austria-Hungary. This is the maximum for a beginning, but also it is the minimum. Most of the argument for conversion is directed to Hungary. Hungary is absolutely necessary for the new Central Europe. The vanity of the Magyars ought to be flattered. Germany cannot stand alone, and the chief prop is to be Hungary. But there are difficulties. Somehow we are reminded of the Athanasian Creed. Each of the three Unities of the future Trinity—which is not three States, but one Super-State—will have its own difficulties of give and take in the process of super-absorption. The new Central Union is to be a union passing the expression of treaties, but it is not to be a merely sentimental bond of affection, though there is some pretty writing—not quite so convincing as usual—from the brotherhood standpoint. Herr Naumann's reflections on the imperfections of treaties and the impossibility of taking into accouut all the possible changes of circumstances are noteworthy. He seems to think that treaties are made to be broken, or, at the least, are liable to be misunderstood and misinterpreted. The view is supported by the very latest of practical illustrations. The result is that the new Central Europe must be bound together by something stronger—far stronger—than any treaties or written covenants. But there are difficulties. Even the Germans—and especially the Prussians, and more particularly the little Prussians (Herr Naumann delights in the adaptation of English modes of thought and expression)—must give up the old habits of thought and of practice and take on the new. The case of Hungary is the most

difficult, but the admission of Hungary as a full partner in the new political business is absolutely necessary.

There is a masterly account of the divergent interests of the three great nations (with their sub-nationalities), and the case against union is put so strongly that the appeal to necessity is, in the end, the real solvent of the difficulties. To each of the Powers isolation means destruction—even to Germany. That is the whole burden of the argument. The demonstration is ruthless. It must be Central Europe or nothing. A most luminous account of the development of present conditions out of the past is an excellent example of that historical method which throughout has dominated the thought of the writer. His object, it is true, is to outline the project of a new Central Europe, but it is not to be made *de novo*. It must grow up in the manner beloved of our own Burke. Each of the three Unities is to surrender to the indissoluble Trinity what is necessary to the common good—military and economic—but is to retain all the national characteristics and functions that are not essential to the new State. Great stress is laid on the retention of original independence in all non-essentials. The old distinction beloved of the examiner between the *Bundesstaat* and the *Staatenbund* is brought in to clear up the ideas. The new Central Europe can never be a *Bundesstaat*—the *Staaten* must retain too much. At the same time, the distinction is shown to be rather one of words than of facts. The distribution of the appellation depends on the estimation of the value of the elements retained compared with the elements rejected. The real difference will depend on the nature of the binding.

Two points call for notice at this stage. If Germany cannot stand alone, *à fortiori* no smaller nation can stand alone. Herr Naumann takes it for granted that the day of the little nation is over. Every little nation must be, so to speak, a client or a dependant of a big World-Power. No little nation can ever again take any real independent part in the decision of peace and war. It must do as its dominant Super-State may direct. Sovereignty in the

proper sense is reserved for the Super-States. Germany itself is too small for a Super-State—hence the need for a Central Europe. The new Central Europe must be big enough to balance Greater Britain, or Russia, or the United States of America—the other three Super-States. Herr Naumann seems specially impressed by the absorbent capacity of the British Empire. Why should the new Central Europe not show in the course of time a similar power? This leads to the second point of interest in connection with the disappearance of the sovereignties of the little nations. Herr Naumann has been greatly influenced in his project of a Central Europe by the course of British history and by the ideas under which the British Empire has been built up. He condemns the old Germanisation by suppression—suppression of language and of race character—and he looks forward to diversity in unity. German toleration in religion after the style of the ancient Roman precedent is not to be wondered at, but toleration in education is also preached. Variation from the Prussian type is to be permitted and even commended. The difference between the old British Empire and the new Central Europe is that in the latter from the beginning in all essentials organisation is to be supreme. Organisation back from the eighteenth century has been the strength of Germany—that also is one of Herr Naumann's foundational ideas. A curious proof of Germany's superiority in organisation is given by Herr Naumann's answer to the very pertinent and interesting question: Why are we Germans not beloved by other nations? The Germans all the world over have been frankly astonished by the absence of love, not to say the presence in most cases of the other thing. Herr Naumann finds the solution in the jealousy in other peoples of the superior German organisation. Probably he is right. Organisation is a word of very wide import. It includes many forms of peaceful penetration which are distasteful to the people penetrated, especially when the full consequences are revealed in a state of war.

In the determination between essentials and non-essentials

in the new State—how much is to be left to the Unities and how much taken up in the Trinity—a considerable debatable margin is left. In fact, in spite of the wealth of facts and history, the argument is in the main simply a reiteration of certain leading ideas. The precise application is left to the march of events—*solvitur ambulando* is the practical answer to most of the practical difficulties.

At the same time these leading ideas are by no means nebulous. They are made perfectly plain, and their practicability is shown in detail. The details may be changed, but they suffice to show how the thing may be done. Perhaps some better way may be found; perhaps not. The point is that the ideas are real working ideas, and not emotional sentiments.

The root idea of all is power—Central European power—power in war and power in trade. The discussion of power in war is limited partly by the present existence of a state of war and the consequent censorship, and partly by the fact that Herr Naumann is a civilian. The treatment is certainly up-to-date—with one exception. The defence of the future, he thinks, will consist first in thousands of miles of trenches and barbed wire, and, secondly, in the accumulation of stores of all the materials necessary for national existence—*e.g.*, food, raw materials, and munitions. Above all, there must be organisation—Teutonic organisation—to pile up and distribute the stores and to man the trenches and ensure the mobility of the Super-State forces behind. There is one omission. No mention is made of the air services. In the next forty years, however, warfare in the earth beneath may give pride of place to warfare in the air above. Perhaps the silence of Herr Naumann in this matter is due to the German censor. Herr Naumann, with his British ideas of toleration and humanity, could hardly have mentioned the air services without a condemnation of the sporadic bombing in the dark of the island of Great Britain. Incidentally, he may be pleased to hear that his present reviewer was privileged to witness a zeppelin display in what the British censor calls the south-east of Scotland.

It was not magnificent and it was not war; it was more like a railway accident than a military operation. The reviewer can well understand Herr Naumann's censored reflections. Perhaps, after the war, his views on this method of preparing for the new Central Europe may be published unrestrained in our *Economic Journal*.

One thing certain about the new Central Europe is that it is to be a first-class military State. There are dark hints that all did not work so well as outsiders were led to believe in the Central Powers' organisation in the present war. The defects are to be remedied by a thorough Prussification. Other nationalities may retain their war-trappings, etc., but the new Central-European army must be one. Not once, but repeatedly, it is asserted that the future is certain to bring forth more wars, and therefore the first duty of Central Europe is to provide for war. The new State is, above all things, to be a military State.

At the same time it is recognised that military power is inseparable from economic power. Accordingly, the economic arrangements of the new Union must, first of all, have regard to defence. Defence is of more importance than opulence. But opulence is necessary to defence, and opulence is the short name for "material interests." The new Union must be strong economically. It must, therefore, be so constructed as to secure to the component parts various forms of economic equality, including equality of opportunity. With this object in view an analysis is given—in itself most excellent—of the economic possibilities of each of the three great nations and of their sub-nations. The principal industries are classified, and so are the principal kinds of foreign trade. An equitable distribution is to be made of national resources, and account is to be taken of the different stages of economic development. The details are liable to change according to experience, and must be read in the book itself. But the ideas that are here applied are of the utmost consequence as regards the after-the-war policy of other nations. They are of special importance to the States of the British Empire.

One of these provocative ideas is that in itself a customs union is not sufficient as the basis of an economic union, and its importance is liable to be exaggerated. In the main a customs union as regards the outside world is a thing to be desired, but such a union would affect very differently the different parts of the new Central Europe. The sudden and complete abolition of the present fiscal restrictions between Germany and Austria and Hungary would lead to disturbances of a ruinous character to important industries. The two latter countries could not withstand the full blast of German competition. In the same way, if the distribution of foreign trade were to be left to the survival of the fittest, Austria and Hungary could not compete with Germany in many branches which from the national standpoint it is important that they should still maintain.

The remedy for the possible evils of such competition is to be found in regulation, and the principal kind of regulation is the regulation by combination. Organisation by syndicates of various kinds is the recognised basis of the production and distribution of the new State. In some cases bounties and in others preferential duties may suffice, but for the most part a much more developed control is contemplated. Spheres of influence are to be assigned both in the home and in the foreign trade. In all the great industries and trades there is no place for unregulated competition. Its place as the primal force is taken by monopoly of varying degrees.

In this syndicating of industry and trade the interests of labour are not forgotten. Professedly quite as much attention is given to labour as to capital, and the profession is not merely verbal, but real. The author recognises that the basis of Central Europe must be democratic. It is true that in a sentence he disclaims the possibility of a republican form of government as non-historical, but it is always implied that the rulers must rule in accordance with the sentiments and the interests of the ruled. During the present war evidences have accumulated that it is not a war imposed on a reluctant people by a military caste, but a war backed by

the full power of national opinion. Recent reports on the guiding ideas of the German trade unions seem to show that the German masses look on the war as necessary to promote their material interests, and they frankly disbelieve that England is actuated by any other motives—*e.g.*, regard for treaties, the rights of smaller nations, etc.

The close connection between military and economic power in Herr Naumann's argument is perhaps responsible for the fact that in dealing with foreign trade he has discarded the old ideas of reciprocal advantage in favour of the still older ideas of mutual exploitation. Peace is war deferred or suppressed. There is no room in Herr Naumann's philosophy for Adam Smith's contention that the richer the neighbours of any State so much the better for that State. The economic policy of the new Central Europe is to be an aggressive policy, directed in every case to the end that in the distribution of the advantages of foreign trade Central Europe should secure the greater share.

There are many side issues of great interest and importance in Herr Naumann's book. Such, for example, is the probable effect of the war on the development of State Socialism. From this point of view the recent advances of the Kaiser to the Socialists, as reported in the Press, are not so much dynastic as evolutionary. Industrial feudalism with the Kaiser as First Industrial is an old idea. Herr Naumann is of opinion that already the present war has shown that Central Europe is prepared to become a great Socialist State. The German defeat of the British blockade is ascribed to the adoption of Socialistic methods.

There can be little doubt that the policy foreshadowed in this book of Herr Naumann represents a large body of opinion both of the ruling official classes and of the masses. In case of a Central Powers' victory, or even of a drawn battle, the policy seems likely to be realised—that is to say, that a great Socialist Military State will be established in Central Europe which, in the course of time, will endeavour to absorb the remainder of non-Russian Europe either by peaceful methods or by war. France, for example, is told

that she will have to choose between playing the part of a somewhat bigger Portugal to England or taking her place with the Central European State. Germany cannot stand alone; still less can France, and still less can Italy.

Herr Naumann, it is true, writes very much under the influence of English ideas as opposed to the old Prussian ideas. One would suppose from his argument that already the Government of Germany is constitutional, as we understand it, and that the Government of the new Central Europe will be still more constitutional. The little nations are to be left full national independence—*except* as regards military and economic power. *Except*—the saving clause is a wide one. Government by consent is to be the new watchword. But when all allowances are made for the influence of English ideas, the Central-European ideal is not the ideal of the British Empire. We cannot think of that Empire growing into a Socialist Military State. Our natural policy, however, must be modified by the policy of a neighbouring Super-State. We must be prepared for the possibility of a still stronger Central Europe.

CHAPTER IX

AFTER THE WAR—WHAT? IN GREAT BRITAIN

Social Unrest; Enforced Economy; Protection; Imperial Solidarity

Prefatory Note

[This paper was written for the *New York Annalist* (March 6, 1916), as one of a series by different economists dealing with the principal countries after the war.]

The subject of the probable economic position of Great Britain and the British Empire after the war naturally falls into two main divisions. First, what will be the effect of the war on the actual condition of the people? and, secondly, what will be the effect on the general industrial and economic policy of the State?

The most fruitful method of inquiry is to consider separately the principal economic changes introduced by the war and to estimate how far they will be modified by the advent of peace. We certainly cannot take it for granted that after the war there will be an easy and rapid resumption of pre-war conditions, and that after an interval for transition things will go on much the same as before the war.

Not much is to be gained by taking a general historical survey of the endings of former great wars because the conditions are so different. As a matter of history some wars have been followed by a great outburst of economic activity and others by a prolonged period of depression. The Germans say that the effects of the Thirty Years' War (1618–48) lasted down to the nineteenth century. On the

other hand, France made a very rapid recovery from the war of 1870–71.

With regard to the present war there are prophets of both kinds already busy with general forecasts. There are prophets of evil and prophets of business as usual. The value of all such forecasts depends entirely on the reasons by which they are supported and by the correctness of the estimate of the particular forces at work.

The Agents of Production—Land

Economic science ought to enable us to give a fairly accurate analysis of the situation, and to suggest the principal lines of inquiry. Let us look at the question first from the point of view of Production as if the nation were a great organisation for turning out the streams of things of all kinds that supply the wants of the people. From this point of view we say that there are three great agents of Production—Land (typical of natural powers and resources), Labour and Capital.

Take first Land in this extended meaning. The other belligerents have had large parts of their lands wasted and put out of condition. Even Germany has suffered in East Prussia. In the United Kingdom, on the other hand, the land as such has probably benefited by the war. There has been no hostile invasion, and the rise in prices has encouraged the farmers to keep the land in the best condition possible. The State has given its assistance in providing the means of fertilisation. Agriculture in all its branches has experienced exceptional prosperity. On the conclusion of the war it will probably be in a stronger position than for many generations.

Labour and Material Capital

In the same way there has been no destruction of mineral wealth or of the means of transport by which the natural resources of the country are utilised. In brief, so far as the first great agent of national production is concerned, the United Kingdom and the British Empire will be as strong as

ever and ready for the resumption of the old extractive industries in full play.

With regard to Labour, although compulsory military service has been adopted, exemptions have been made of important industries and of important classes of labour. The general complaint is that too many men have been "starred" rather than too few. The governing idea has been to keep the industrial position of the country in a satisfactory condition.

Unfortunately, there will be an actual loss of many thousands of men by the wastage of war, but, on the other hand, the war has called into industrial activity large numbers of women and children. There will certainly be no difficulty after the war in the supply of labour. On the contrary, there may be some trouble in finding occupation for the disbanded soldiers and in displacing the women.

The case of the third great agent in Production, namely, Capital, is not so simple. The various forms of fixed capital will no doubt remain with us practically unimpaired. In some cases there may be deterioration, *e.g.*, through the want of renewal of railway plant, but from the national point of view the actual wastage of fixed capital cannot be very great. There has been, on the other hand, a considerable creation of a mass of fixed capital for war purposes, and some of this may be converted to the arts of peace without very great loss, *e.g.*, some of the great engineering works constructed by the State. In many cases the needs of war have been met by the conversion of peace industries, and the reconversion will not be difficult. On the whole, there will be some loss of fixed capital through the war, but hardly enough to seriously affect the national productivity

Immaterial Capital

With regard to the forms of productive capital, which economists class as immaterial, the loss will also be inconsiderable. In some respects there may be a positive gain. The war has awakened the people generally to the recognition of the uses of science in all its branches and the need for

greater organisation. Even the Government and the immediate advisers of the Government have begun to see that the living immaterial capital is of greater importance than the accumulated dead capital in material forms. We may learn from our enemies some things in this direction, and through all its history the British people has imitated foreign methods whenever it seemed desirable.

Contrary to what was expected after the first few days the banking system of the country resumed its normal working. The published results of the year 1915, the first complete year of the war, are surprising. Banking business has increased except in one direction, namely, through the restrictions placed on Stock Exchange dealings and on the creation of new companies and the issues of new capital. Except in London—through the restriction of financial business of this kind—there has been a large increase in bankers' clearings and in the gross profits of banking business.

The absorption of a large part of the gross profits in writing off depreciation of securities, though lessening dividends for the time, will so far put the banks in a very strong position after the war. There will no doubt be difficulties when the inevitable contraction of Governmental credit operations begins to operate, but so far as national production is concerned our banking system has remained in full working order. If any fault is to be found it is that the credit system of the country has worked too easily and is partly accountable for the inflation of prices that has certainly taken place.

Surpassing Records of Peace

The general result of this broad survey of Production is that in the middle of the second year of the war the economic prosperity of the United Kingdom has surpassed the records of peace. Official unemployment is a fraction of 1 per cent. Never were the records of pauperism so low. All the figures point to an increase in the consuming power of the people. No doubt a large part of this consumption is of imported commodities, but from the production point of view this

importation has only been possible by our credit organisation and by our former accumulations of money power.

So far as Production is concerned, there is no reason to suppose that the United Kingdom or the British Empire has suffered up to the present any serious impairment of its powers. Even if the national debt before the end of the war should amount to the colossal sum of four thousand millions, which is quite possible, we must remember that the chief real burden for the future consists in the payment of the interest, (say) some two hundred millions. A good deal of this money will be in the nature of a redistribution of national wealth, as the greater part of the loans are internal. The necessary taxes will in part check consumption, and the check from any point of view except the pleasures of the moment may be beneficial to the nation at large. Production, however, is only one of the great economic departments, and is inextricably intertwined with Distribution and Exchange. The end of the war may bring dislocations in these departments.

Effect on Wealth Distribution

The war has had much more serious effects on the distribution of wealth than on the aggregate amount available for consumption. In normal times the distribution of the "earnings-and-interest" fund depends in the main on an endless series of contracts made by the various owners or controllers of the great productive agents. From year to year there are only moderate changes in the proportions of wages, profits, and rents in their various forms. Again, as regards the part taken by the State for public purposes, the expenditure is for the most part determined, under normal peace conditions, by the policy of former years. There are fixed charges for the old debt and for the public services, military and civil. In short, a very small proportion of the public revenue is at the disposal of the Government (with the approval of Parliament) for new purposes.

The sudden advent of a great war changed altogether the immediate powers of the Government over the actual distri-

bution of the wealth of the nation. And the indirect effects of Governmental action were equally serious. The Government, instead of having to dispose of an almost negligible amount of new revenues in any one year, has had at its disposal (say) fifteen hundred millions of new money. Almost the whole of this new money is raised by loans, and almost the whole of it is ostensibly devoted to the conduct of the war. The reduction of civil expenditure, whether national or local, has been insignificant. Equally negligible has been the economy effected by the people in general, since the indirect taxation imposed has been altogether inadequate.

Spending the Money: Labour and Wages

The first consequence of this plan of new money under State control has been a sudden and great increase in the demand for all kinds of labour and capital that could be used for war. This rise in demand was accompanied by a corresponding rise in wages and profits. Under our voluntary system it was thought just or advisable to offer large allowances to the dependants of our soldiers. The money wages paid to the soldiers was ten or twenty times as great as with the other belligerents, and yet apart from patriotic motives was not sufficient to draw all the labour required. Partly with the view of attracting men the real wages of the soldiers reached a very high standard. Rations were most liberal, both in quantity and in quality. No doubt under patriotic impulses a good many men joined the army at a loss of material comfort (apart from the risks of life and limb), but, on the other hand, there were large numbers of ordinary workers who benefited by enlistment. This is especially true if we take as the unit the family. Many working-class families received more money than before the war and had not the bread-winner to keep.

The result was that the Governmental expenditure on the war raised the general rate of wages. As the demand for munitions became more urgent the wages of labour were raised more and more in the war industries. The inevitable

consequence was a sympathetic rise in all other forms of labour. A general demand sprang up all over the country for advances in wages in the name of war bonuses. On the whole the advances in wages were more than sufficient to balance the rise in the cost of living.

A rise in the general standard of comfort of the labouring classes seems a paradoxical outcome from the greatest war on record, especially when we look at the state of labour in the other belligerent countries. The reason is, first, that our Government obtained its loans more easily and, owing to our voluntary system, gave full play to the consequences of a rise in the demand for labour. Other countries had less money and, being organised for war under the compulsory system, were able to exercise a buyers' monopoly for all sorts of services. Instead of giving labour more than the ordinary peace rates, in many cases they gave less.

Capital Profits and Rent of Land

The case of capital was practically on all fours with that of labour, but with an even greater advantage in bargaining against the Government. In this country it had come to be recognised as a secondary law of nature that the Government, in the making of war contracts, must pay extravagant prices. This war being the greatest of all our wars, it was taken for granted that the extravagance must also be the greatest. In the course of time some of the war contracts have been revised; some of the war industries have been controlled, and some of the excess profits have been seized by the tax-gatherer, but the general result has been a great rise in the profits of all industries connected with the war. There has been a sympathetic reaction on other employments of capital. The money profits and the money wages in the favoured industries had to be spent. It is not part of British human nature to save extra earnings in any parsimonious manner. And again we are brought face to face with the extraordinary fictitious prosperity of the war!

In the foregoing account of the movement in profits no

attention has been paid to the different elements into which gross profits may be analysed. In every element there has been a rise. Even as regards insurance against risk the Government took over some of the risks or provided cheap insurance. Monopolies were permitted to emerge and flourish. Unearned increments abounded. Even the rate of interest on first-class securities was promptly raised by the Governmental demand. The British Government, after about a year of war, had to give 5 per cent. with indirect bonuses.

With regard to the rent of agricultural land the landowners have not so far benefited very much, if at all. The land is let in general to tenant farmers on such customary or contractual conditions that rents cannot at once be raised. It is the farmers who have got the unearned increments in the meantime. The estates of many landowners are mortgaged heavily and the rise in the rate of interest has been taken advantage of by the mortgagees. But the rise in rents must come about in due season if prices and farmers' profits remain high.

General Result of Survey

The general result of this rapid survey of distribution is that the earnings of labour and of capital have increased greatly through the vast Governmental expenditure. That the rise has not been merely a nominal or money rise is shown by the great increase in consuming power from beer up to costly furs. As a nation we have been spending capital with profusion. Certain classes have suffered severely, especially the professional classes with fixed or lowered incomes, who have to bear the increase in income tax.

With regard to the third great department of economic activity, namely, Exchange, the chief effects have already been noticed in connection with Production and Distribution, for exchange is fundamental in both. There are, however, certain forms of the organisation of exchange which call for some special notice, notably the monetary system and foreign trade.

Banking

With regard to money and banking on the outbreak of war in the expectation of a crisis various emergency measures were taken, some of which were unduly prolonged. Before the end of 1915 the Government had issued more than a hundred millions of Treasury notes for ten shillings and one pound. Having regard to the enormous development of our cheque system, this great amount of new paper money seemed unnecessary. Coincidently, there was an expansion of bankers' credits owing to Governmental guarantees of various kinds. The natural result was a general inflation of prices. Of the fact of the general rise in prices there is no doubt, and the great increase in money and credit is, to say the least, a contributory cause. But for the Treasury notes the banks must have contracted their advances. The rise in prices (whatever be the cause assigned) reacted on public expenditure. The loans were sooner expended and new money had to be raised. Much would have more. Prices followed money and money prices in a vicious circle.

So far importation was increased and exportation was diminished. The adverse balance of trade consequent on the war was aggravated. Attempts were made to correct the foreign exchanges, especially with the United States, by public and private loans, and when these proved insufficient, by the export under Governmental control of securities. The ulterior effects of these loans and sales of securities must be to diminish our power of importation after the war. Instead of receiving interest from abroad in the way of imports, we shall be imposing taxes in the home country to pay interest.

Adverse Trade Balance

The adverse balance of trade is due in the first place to the exceptional war demands, but with lower prices in this country the deficit would have been less. One of the most notable advances in price was in freights. Much mercantile shipping was swept from the seas and much was commandeered by the British Government. The shortness of

supply and the rise in demand in some cases raised freights ten or twenty fold. The rise in freights would not have been so great but for the general rise in prices and the consequent encouragement to importation. Even in such a staple as wheat the difference in price in England and the United States is not wholly accounted for by the difference in freight. The rise in freights in one way was equivalent to an increase in one of our invisible exports, but, on the other hand, it checked visible exports and also operated against us so far as neutral shipping was concerned. Some of our shipping was also diverted to the carrying trade for neutrals.

After the War

We are now in a position in the light of this broad survey to estimate the probable course of economic development after the war.

The change of the greatest immediate importance will be the cessation of public borrowing and of excessive Governmental expenditure and the substitution therefore of a great increase in the burden of taxation compared with the former peace level. The fictitious prosperity of the war with all that it implies must come to an end. The change will be so severe that in all probability under various excuses Governmental borrowing will not cease altogether, but it will be increasingly difficult and must be very greatly contracted.

In the same way all the varied emergency measures for supporting credit must be much lessened and in the end disappear. Here again, no doubt, there will be an outcry for more money, and for more assistance to the banks. It will be very difficult to manage the transition from the inflation of war to the natural level of peace. The attempt to take away the war bonuses on wages will no doubt be resisted by labour. To revert to a lower standard of comfort on the return of peace will seem unnatural and unendurable. Possibly some grave social disturbances may arise. Everything points to a fall in wages. The price of labour must share in the general fall of prices with the reduction of paper money and war credits. There is likely to be an

over-supply of labour, while the special war demands will have ceased. The expansion of exports can hardly be enough to replace the fall in the war demands for labour.

Similar reasoning applies to profits. During the war the rise in profits has been due to public expenditure, and the revival in the trades and industries of peace will not give at once an adequate compensation.

Under these circumstances, on the return of peace there will no doubt be a great outcry for Governmental assistance to industry. The wisest policy, no doubt, will be to refuse all such assistance as may demand more new money. Whether our statesmen will be strong enough to make the refusal and to insist on real and effective economy remains to be seen. The moral effect of our war extravagance will be hard to eradicate. The people are not likely to take kindly to the more simple life and to the repayment of old debts. They are more likely to expect with the return of peace an increase in the social benefits which were being provided in an increasing degree before the war. They will suppose that the war simply stopped for the time the advance in social improvement and that the march toward State Socialism will be resumed where it was left off.

Governmental Management

On the other hand, the Governmental management of industry during the war has not been such as to encourage its further extension. All the old complaints against the substitution of State management for private enterprise have been revived during the war. It is true that more and more State management was asked for, but, as it was given, the complaints increased. The most persistent of all complaints has been that the Government did not take sufficient advantage of the business powers of the community.

Everybody has been crying out for business men to replace incompetent State officials. Such has been the outcry that the popular disbelief in the benefits of red tape has been greatly strengthened. When the inevitable commissions of inquiry have revealed to some extent the

details of Governmental mismanagement and extravagance, a healthy reaction in favour of self-help may set in. In any case, the extension of socialistic interference will meet the insuperable obstacle, in the course of a very short time, of the provision of the necessary money. As the war will probably double our taxes, to pay for interest, pensions, etc., new revenue for social experiments will be difficult to obtain.

The dangers of social disturbances ought not to be exaggerated. The British people are not inclined by nature or tradition to social revolution. In case of need they are capable of great endurance. If only they realise that the taxation is necessary they will shoulder the burden without destroying the system by which the national wealth has been built up. It is quite possible that a strong reaction in favour of individualism may take the place of any further extension of socialism. Socialism when it has to be paid for by taxes is too expensive a luxury after a great war.

But with regard to our external trade and generally our relations with foreign countries, a strong demand has already arisen for the abandonment after the war of our former easy-going free trade. Debates in Parliament and resolutions by chambers of commerce all over the country show unmistakably the trend of public opinion. The conclusion of war will not be marked by the pre-war conditions of foreign trade.

Restraints and Preferences

Already definite proposals are being discussed for particular restraints and preferences. Even if the British people were persuaded that the adoption of a restrictive policy toward our present enemies would involve a monetary loss they would accept the loss. In particular, they are not likely to look again with complacency on the growth of German navigation and the expulsion of our ships from old trade routes. Some revival of our old navigation policy seems very likely. And for the very same reasons for which Adam Smith approved of the old Navigation Acts. These

old regulations, he allowed, were not favourable to the growth of national opulence, and they were the outcome of national animosity (against the Dutch), but for all that he considered that they were the wisest of the commercial regulations of England. His pithy summary, "Defence is of more importance than opulence," is being quoted by every chairman at the annual meeting of his company.

Coincidentally with restraints on our enemies there will be, no doubt, an extension of the system of preferences to our allies, and especially there will be a closer union between all the States of the British Empire. Before the war a closer commercial union was rendered difficult by the divergence of interests and the difficulty of the initial cost. The feeling of solidarity created by the war will induce every part of the Empire to look more to the power of the whole rather than to its own particular interests.

German Methods

This is not the occasion to discuss the German methods of waging war. From the German point of view they may be capable of defence in the eyes of the German people and their friends. But, such as they are, they have aroused in the British people such a degree of national animosity as can only be effaced by length of time and a complete repudiation by the German people of the morality of militarism. So long as the present national feeling endures it is safe to predict that on the return of peace German ships will not find the ports of the British Empire so free of access. Nor will the same easy entrance be admitted of German subjects into our industries, and still less will they be permitted to exploit monopolies under the shadow of our law.

It is quite possible that this anti-German policy and the attempts to capture German trade by scientific tariffs may break down owing to the difficulties involved. In spite of the strong praise of Adam Smith and the national worship of the power of the sea, the Navigation Acts were the first part of the old system to give way owing to the immense practical difficulties of making the necessary reciprocity

treaties with other nations. But within practical limits a considerable change in our foreign trade policy and in our inter-imperial policy may be made with every prospect of success.

There can be no question that the attempt will be made after the war to advance British commercial power at the expense of German power, especially by a closer union of the British Empire. Before the war we had no more jealousy of the advance of German trade than we had of the advance of the trade of the United States. For a considerable time, however, we shall not look with such an easy mind on German advancement.

Unfortunately, one of the results of the war will be to bring into favour military modes of thought in dealing with the commerce of nations. For a time there will be a reversion to the old belief that the gain of one nation means the loss of another, especially if one nation is German and the other British.

CHAPTER X

TRADE AFTER THE NAPOLEONIC WAR *

WITH SOME COMPARISON BETWEEN PRESENT CONDITIONS AND THOSE OF A HUNDRED YEARS AGO

PREFATORY NOTE

[FAR too little attention has been given by economists in recent times to the great work of Tooke on the Napoleonic war period and after. The historical part of the present paper is drawn largely from Tooke.]

Next to the war itself the subject that is perhaps most discussed at the present time is trade after the war. Trade is taken in its largest sense as covering practically all the economic activities of the nation: *e.g.*, agricultural and manufacturing production, transport and markets—both home and foreign—employment and wages of labour, employment and profits of capital, the burden of war debt and taxation, credit and banking, and the effects on prices. All these topics are closely inter-connected, and all and more must be drawn in due proportion for a proper picture of "trade after the war." When the picture has to be drawn largely from conjecture the general effect will vary according to the stress laid on the different elements. From the same facts and conjectures the economic forecast may be black or bright according to variations in stress.

The application of the historical method to what occurred after the great Napoleonic wars ought to be useful in suggesting lines of inquiry and in realising the complexity of the

* First published in the *Scottish Historical Review*, July, 1917.

subject. There are points of resemblance and of difference well worthy of consideration, both in general and in particular.

A point of general interest may be first noticed. It was commonly believed in the Napoleonic period that the return of peace would create an immense foreign demand for the goods of this country and its colonies. Accordingly as soon as peace seemed probable there was an outburst of speculation in all kinds of exportable commodities. It may be said to have reached its height just after the abdication of Napoleon in the spring of 1814. The extravagant speculation for British manufactures caused an unusual demand for labour with rising wages. Incidentally there happened to be a fall in the prices of provisions, so that the manufacturing workers were much better off.

So far the first general comparison is favourable to our optimistic prophets who foresee a great peace boom both for capital and for labour. It soon turned out, however, that as regards trade the prosperity was artificial and ephemeral. The shippers found that the effective demand for British goods and colonial produce had been greatly over-rated. The desire element in the demand was strong enough. The foreigners intensely wanted our goods, both home-made and colonial—there was a great demand in the sense of desire to possess, but the means of purchase were proportionately limited. Accordingly great losses were incurred on goods shipped to the Continent in 1814, and towards the close of the year numerous failures took place, which continued in increasing numbers in 1815 and the early part of 1816.

The popular belief of that time in a peace boom is well brought out in the evidence of a hand-loom weaver before a Select Committee of the House of Commons in 1833, quoted by Tooke.* "Can you remember what was the reason that the price of weaving sixty-reed cambrics was so high in 1814?" Answered, "It was in consequence of the battles of Leipzic and Dresden. A general opinion pre-

* Vol. ii., p. 6, *n*.

vailed that if we could succeed in destroying the power of Buonaparte, wages would get up and prices would be confirmed to this country for ever; and prices got up to an enormous height, and they came down as fast."

The fall in the prices of produce from the highest in 1813–14 to the lowest in 1815–16 was remarkable. Raw cotton fell to just one-half, sugar to less than one-half, logwood and pepper to one-third of the highest points. Copper fell from £140 per ton in 1813–14 to £85, lead from £33 to £18, and tin from £174 to £102.

The fall in the prices of produce was irregular, but the lowest point of depression between 1814–17 was in general touched at the end of 1816 and the beginning of 1817.

In this period there was also a considerable depression in the shipping interest. There was indeed a more extended field for tonnage, but voyages were quicker through the removal of the impediments of war, a large mass of shipping was liberated from transport, and the cost of shipbuilding fell with the cost of materials, and with it the price of ships.

The general conclusion of Tooke * is well worth quoting in full :—

"Thus there was from 1814–16 a very general depression in the prices of nearly all productions, and in the value of fixed property, entailing a convergence of losses and failures among the agricultural, and commercial, and manufacturing, and mining, and shipping and building interests which marked that period as one of the most extensive suffering and distress. Of that great and memorable fall in prices the principal part beyond what was the effect of the seasons and a recoil from the extravagant speculations in exportable commodities is clearly attributable to the transition from war to peace; not from war as having caused extra demand, but as having obstructed supply and increased the cost of production; nor to peace as having been attended with diminished consumption but as having extended the sources of supply, and reduced the cost of production."

When it is stated in the foregoing passage that the period 1814–16 was one of most extensive suffering and distress, the reference is to the employers' capital and profits, and

* Vol. ii., p. 12.

not to the general conditions of the masses of the people. As regards the labouring classes, Tooke goes on to say that in

> "1814–15 and until the renewed rise in the price of provisions they were in a comparatively satisfactory state; as the price of labour had not fallen in anything like the proportion of the fall of the prices of necessaries . . . the great bulk of the working population were in an improved state compared with that which they experienced in 1812."

One of the most important results of the application of the historical method to economics is the observation that with a general rise in prices from whatever cause as a rule the working classes suffer more as consumers and gain less as producers than the employing classes. Conversely, in the case of a *general* fall in prices the working classes benefit relatively to the employers—money wages do not fall so rapidly as prices, and in some cases do not fall at all, *e.g.*, from 1876–96. Like all other empirical laws, however, this law of prices must not be rashly extended in time or place without full consideration of the attendant circumstances. Accordingly, before any application can be made of the effects of the changes in the price-level of the Napoleonic period regard must be paid to the causes of the changes.

On this subject a very keen controversy arose which has been prolonged down to our own times. The origin and the progress of the controversy are displayed in full detail in Tooke's great "History of Prices," and indeed this work itself was undertaken in the first place with special reference to this controversy. The *magnum opus*, the first two volumes of which were published in 1838, was founded on earlier essays which arose directly out of the controversy.

As is observed by Tooke in his Introduction, in the publications without number on the subject of the high range of prices during the great wars and the low range in the following period, the explanations offered fall into two great classes, or are concerned with two great causes, namely, the War and the Currency.

During the first two years of our present great war people were content to ascribe the continuous rise in prices to the

war simply, but in the beginning of 1917, with the issue of the great consolidating loan, more attention was directed to the rise in prices as consequent on the inflation of currency and credit.

It seems probable that in the near future the old controversy between War and Currency will be revived with reference to price movements in and after the present war. The analogies and contracts with the former period cannot fail to be instructive.

Tooke himself began with a preliminary inquiry into the effects of war and currency on prices in former epochs of English history. He proved, as regards war, that the popular idea that war always raised prices was not well founded historically, inasmuch as ranges of high and low prices were about evenly divided between periods of war and peace. In the same way he showed that the nature and extent of the effects of variations in the quantity of money had been too easily taken for granted even by Adam Smith himself.

War is a very short word, but a state of war involves a multitude of causes and conditions acting in different ways on the economic state of the nation. Similarly as regards currency, there is no simple connection between the aggregate of the various forms of currency and of credit on the one side and prices on the other. Just as the state of war must be analysed so must the state of the circulation of money and its representatives.

In this short paper no more can be attempted than a statement of the principal results of the former controversy, with a brief indication of some of the points of contrast with present conditions.

First of all, Tooke himself called attention to a cause of high and low prices which, in his opinion, often altogether outweighed the effect of war or currency, namely, the state of the seasons. One of the most valuable parts of his work is the detailed examination of the effects of the seasons on prices. England during the Napoleonic war period was practically dependent on its own food supplies. A shortage

due to bad weather raised prices out of all proportion to the deficiency. As a consequence, a period of bad seasons was the very best for the farmers, and also for the landlords, if it was long enough to allow for an adjustment of rents. The Corn Laws * were practically inoperative in the whole Napoleonic period. The great cause affecting corn prices was the weather. People were too much struck by the rise in prices to observe that even in this period there were years of low prices. Tooke showed in general and in particular that just as scarcity unduly raises, so abundance unduly lowers, prices. Part of the excess supply of one or two good years may be stored, but a continuance of good seasons will cause prices to fall still more by the release of the stored grain.

The best way to see the full effect of the seasons in this Napoleonic period is to take account not only of the average prices of the year but of the fluctuations. The average price of wheat in 1801 is given in the usual tables as 115*s.* 11*d.* Certainly a high price, but " before the harvest of 1801 was secured the price of wheat in the London market reached 180*s.* and the price of the quartern loaf was for four weeks 1*s.* 10½*d.*" † In 1812 the average is given as 122*s.* 8*d.*, but the price in August reached 155*s.*‡ By December, 1813, the price had fallen to 73*s.* 6*d.*, less than half of August, 1812, but the average for 1813 was 106*s.* 6*d.*

It is quite clear from Tooke's " History " that the average high prices of corn were due to the bad seasons. A single good season was sufficient to break the prices, and with two good seasons prices fell greatly. Between March, 1801, and March, 1804, wheat fell from 155*s.* to 49*s.* 6*d.*, the sharpest fall on record.

Before the present war the influence of British weather had ceased to be of any practical importance as regards the price of grain, as was shown by the great agricultural depression in the early 'seventies, in which bad seasons received

* *Cf.* my " History of the English Corn Laws " (Social Science Series).
† Porter's " Progress of the Nation," p. 452.
‡ Tooke, vol. ii., p. 342.

no compensation from high prices, which indeed made a low record for modern times. Even during the course of the present war it cannot be said that British weather has been the chief cause of the rise in food prices. The world harvest of 1916 was deficient, and the destruction of tonnage and the demand for transport had increased. In 1917 the submarine menace has been intensified, and the available supply of cereals depends most upon importation. Steps have been taken in this country to enlarge greatly the area of tillage and restore our food independence. If the new cultivation were protected by import duties the price of British wheat would again be governed by British weather. It seems probable, however, that minimum prices will be maintained by bounties (direct or indirect) and not by import duties. After the war it is hardly likely that world harvests will be deficient. It is more probable that the recent great advance in agricultural scientific work will rapidly bear fruit under the stimulus of exceptional demand. Hitherto agricultural practice on a large scale has lagged behind scientific discovery, especially in the United States.

It seems probable also that after the war the relative shortage of ships will soon be made good, partly by new construction and partly by the liberation of tonnage from naval requirements.

So far as the conditions of supply are concerned, the cause of most importance in the time of Tooke, namely, the seasons, will take a second or much lower place. It is also possible that the foreign peace demand for our goods may not be so ephemeral or defective as in the earlier peace period.

But there remains for comparison one point of vital importance, namely, the currency. Tooke showed very clearly that the effects on prices of the Bank Restriction (that is to say, the adoption of inconvertible notes) during the war were exaggerated. Very often a rise in prices occurred, due to bad seasons or other obstructions of supply, which was ascribed to excessive issues of notes when, in fact, no excess had occurred. Tooke's examination of the actual conditions of the circulation is a model of judicial inquiry. All the

same it is now generally agreed that the Restriction (or the inconvertibility) had more influence than he supposed.

An impartial investigation of monetary conditions in the present war shows that there has been considerable inflation I have written at length elsewhere on this matter.* Here it need only be said that inflation is now so generally admitted that the main concern of financial authorities is to discover the best means of deflation.

Granted present inflation, it follows of necessity that if the gold standard is restored to its pre-war simplicity and efficiency, there must be a great fall in prices. The present high level is largely due to the *de facto* abandonment of the gold standard.

After the Napoleonic wars the principal feature in the economic situation was the falling prices. There was some recovery from the fall already described (1814–16), but from 1818–22 there was another great fall—according to the index numbers of Sauerbeck—a fall from 142 in 1818 to 100 in 1822. There was a reaction up to 1815, and then the depression of prices was renewed. The general result was that the cessation of war was followed by a long period of falling prices.

This fall in prices was ascribed by many to the re-establishment of the gold standard, and the resumption of specie payments by the Bank of England, in accordance with the Report of the famous Bullion Committee of 1810. All the well-known arguments in favour of inflation were brought forward in opposition to the reversion to the gold standard in its old form. Many argued that in effect the war had established a new level of prices and that it would be most unjust to resort to the old level. Contracts, it was urged, had been entered into which would be vitiated by being interpreted in terms of the old standard. The results of this old controversy were incorporated in all the text-books on political economy. The rugged arithmetic of Ricardo

* *Cf.* "Inflation and the Rise in Prices," *Economic Journal*, December, 1916, and the "Statistical Aspects of Inflation" in the *Journal of the Royal Statistical Society*, July, 1917. See above, Chapters IV., V.

was transmuted into the thin lucidity of Mill (in Mr. Balfour's unhappy phrase). All this learning, however, had been forgotten before the present war, or rather it was branded as academic and therefore non-practical. It was forgotten that Ricardo made a fortune in business, that Tooke was a great merchant, and that the old controversy on inflation and deflation was waged by practical men interested in practical results. There can be little doubt, however, that the old controversy will again break out after the war, and no better preparation could be made than a careful study of the great war and the great peace a hundred years ago.

PART II

Prefatory Note to Part II.

The following papers (with the addition of a few notes) are printed exactly as they appeared in the *Scotsman* at the dates pre-fixed. Apart from any critical or constructive value they may possess, it is hoped that they may be useful as a record of British economic war policy and of the opinions by which it was guided. As explained in the General Introduction, the writer alone was responsible for the papers as published.

J. S. N.

September, 1917.

CHAPTER I

THE EFFECTS OF WAR ON GENERAL PRICES

(*August* 3, 1914)

Prefatory Note

[This article was published the day before the declaration of war by Britain. In view of the rise of prices that has actually taken place we are now inclined to suppose that in war-time a great rise in prices is inevitable. Historically this is not true. Even in the present war up to the end of 1914 there was no great rise in prices—the *Economist* index number rose less than 10 per cent. up to the end of September, and for the last quarter of the year remained stationary. In the United States in September, 1913, the index number was 103; in September, 1914, it rose to 104, but fell back to 103 in September, 1915. As shown in a later article ("Economic Prosperity of War Time," see below, p. 241), during the first five months of war trade in the United States was depressed. As the war was prolonged and extended each of three great causes here examined contributed with increasing force to a rise in prices. Openly or tacitly the belligerents resorted to inconvertibility. The gold extruded into the neutral countries raised prices there in terms of gold. In the belligerents besides inconvertibility there was an extraordinary inflation of credit. Especially with the extension of submarine activity the war assumed more and more an anti-commercial character and prices rose by the impediments to supply. If the war had been as short as the Franco-German war of 1870–71 and Britain had kept out of it, the course of prices would probably have been the same as in 1870–71, *i.e.*, a moderate rise in the war and a boom afterwards.]

There has always been a popular idea that war raises prices. In the first volume of his great work on the "History of Prices," Tooke examined the idea with special reference to prices in England in the Napoleonic wars. By way of introduction, he shows that in the eighteenth century wars with high prices and wars with low prices were about equally divided. He accounts for the very high prices of the Napoleonic wars by their specially anti-commercial character coupled with very bad seasons. If we look to the course of prices in England during the later wars of the nineteenth century, we find that in the Crimean War (1854–55) prices fell slightly, in the American Civil War there was a considerable rise in prices, but prices had begun to fall before its conclusion. In the Franco-German War (1870–71) there was a slight rise during the war, followed by a very great rise after the peace culminating in 1873. In the South African War prices fell, and in the Russo-Japanese War there was a rise. It is quite clear from this rapid survey of the wars of the past two centuries that we can make no simple appeal to experience; we must follow the method adopted by Tooke, and look to the different ways in which wars may affect prices, and consider which of these modes is of the greatest importance at the present time. Of course, by prices we mean general prices, such as are indicated by the averages of prices as given by the index numbers of the *Economist* or Mr. Sauerbeck. Everyone knows that, estimated in this way, general prices in England suffered an enormous fall from 1873–95, in Sauerbeck's figures from 111 to 61—that is to say, general prices fell about 45 per cent. Since 1895, there has been a continuous rise (with fluctuations), especially marked during the last ten years. From the figures of the last year it seemed as if the rise had been checked. The question is—What will be the effect of a great European war on general prices?

It is found by economic analysis (confirmed by reference to experience) that general prices depend on a number of forces acting in different directions. The difficulty in any particular case is to select the most important and to balance

the effects. In the present paper three great causes only will be considered, which are always of fundamental importance, and at present seem to dominate the situation—namely gold, credit, and the volume of trade.

Since the great discoveries of gold in Australia and California in the 'fifties movements in general prices have always been associated with the gold supplies. The fall after 1873 was ascribed to the fall in the production of gold, and the rise after 1895 has been also ascribed to the enormous increase in the output. At first sight it looks as if general prices moved simply in response to the decrease or increase in the supplies from the mines. It is easy to show, however, that the connection between the supply of gold and the movement in prices is by no means simple. The change in the supplies of new gold is only one, and not always the most important influence. Many observers, for example, have been so much struck by the growth of credit that they seem to think that an increase or decrease of gold is now of no more importance than that of any other staple of commerce. Any form of wealth, they suppose, can be made the basis of credit, and credit means purchasing power.

It is no doubt true that credit-substitutes for metallic money are used for the great mass of commercial transactions, but, as the events of the last week have shown in a startling manner, gold is still the basis of the credit structure. Even before the war crisis there were signs that credit had been pushed to the extreme, especially in new countries, *e.g.*, Canada, which had been borrowing largely from Europe for the development of their resources.

Whether we consider gold or credit, or both, as the main cause in affecting the amount of "money" in circulation, we must also take account of the work to be done. If there are more things to be exchanged then more money is required. Or, putting it otherwise, expanding trade could not be carried on except at a lower level of prices, unless there were a corresponding increase in "money" and its effective substitutes.

With these general ideas as guides the effects of a great war

on prices may be considered from three points of view—namely, as affecting gold, credit, and trade.

As regards gold the general effect of war is to cause an exceptional demand, and at the same time to withdraw large amounts from effective monetary uses, the gold being hoarded in different forms, *e.g.*, in the reserves of banks, in war chests, in the coffers of private persons. Probably last week the demand for gold was unprecedented, whilst on the Continent at any rate a good deal vanished from effective monetary use. The relative scarcity of gold, coupled with this exceptional demand, must (other things being the same) tend to pull down general prices. With regard to credit, it is obvious that the outbreak of war, or even the fear of war, is the most powerful of all causes in putting a check on the expansion of credit and in causing a great contraction. The rise of the Bank rate to 10 per cent. is the surest sign of the strain imposed on credit. Credit is now international, and a collapse of credit cannot occur on a large scale in any one country without affecting all other countries. The crisis in credit has been felt as severely in New York as in Paris—more severely, indeed, because in New York credit is more highly (and rashly) developed. Here again, then, a great war is likely to cause a great contraction of credit, and so far a fall in prices such as usually occurs after any great commercial crisis.

It may, of course, be argued that if credit is lessened in one form it will be increased in others, especially by the issue of bank-notes. If, however, these notes are convertible into gold on demand, the increase of issues, compared with the destruction of ordinary forms of credit, must be very small. If, for example, the Bank Act of 1844 is suspended in this country, that only means that the Bank of England may issue more than the statutory amount of notes without gold being offered for them. It does not mean that the notes are inconvertible, or that the Bank will not give gold on their presentation.

If the notes issued are really inconvertible—that is to say, if the banks concerned do not give gold on demand, then

there is no limit to the rise in prices in terms of these notes except in the limitation of the issues. But under these conditions gold itself would also rise in price, or would bear a premium, and in estimating the true movement in prices the depreciation of the notes must be allowed for. In general the issue of inconvertible notes leads to a contraction of the credit of the issuing country.

There remains the effect of war upon trade, or more generally on the volume of commodities to be circulated by means of the money, whether metallic or credit-substitutes. Here the effect is not so obvious. If the war is widespread enough to seriously check production, then so far the tendency of prices is to rise. But how far does a great war check the world's production? In the parts devastated no doubt the effect is clear, but what about the parts of the world which are not in a state of war? Are we not told even now that Europe's misfortune is America's opportunity—that there will be an enormous boom in American trade? This complacent prophecy does not seem on general grounds likely to be fulfilled. If America pours goods into Europe, how is she to be paid? Not in goods, for the very idea is that less are produced; and not in credit, for again there is less to draw on.

The general effect of war on the volume of trade would seem to be a considerable reduction. There will, therefore, be less work to be done by money and money substitutes, and therefore so far prices would tend to rise—meaning, of course, general prices.

If now we try to make an estimate of the resultant effect of these three great influences operating on general prices, there seems to be no doubt that the loss in money power (gold and credit) will more than counter-balance the check to production. Production will only be directly checked in the area of disturbance—in the rest of the world that remains at peace things will go on much as before, except for the foreign trade, and all the world over the foreign trade is of relatively small importance compared with the home trade.

The general conclusion, then, seems to be that as the

result of a great European war we may expect a general fall in prices on the average. There will, of course, be a great disturbance of relative prices *inter se*: some things will rise greatly and others will suffer a very great fall, but on balance the trend will be downward. If such a general fall of prices does occur, the sequel must be a fall in profit and an increase of unemployment, even if the British Empire keeps out of the war. If we are involved it is possible that, as in the Napoleonic wars, the war may assume an anti-commercial character, and the consequent increase in cost of production and check on the volume of trade may become the dominating influences and cause a rise in prices.

CHAPTER II

WAR AND PAPER MONEY

(*August* 18, 1914)

In a recent article in the *Times* it was stated amongst other signs of encouragement that the country is full of money. The question at once arises—What is money? The standard money of this country is gold, and the total amount of gold in the banks and in circulation is generally reckoned at a little over one hundred millions sterling. In Germany, it may be noted, the amount is nearly two hundred millions. Besides the gold we have also a certain amount of token coins made of silver and bronze. But as the metallic value of the silver coins is at present not half the nominal value, the silver in the shilling being perhaps worth fivepence, silver token coins are not full legal tender, but only to the extent of forty shillings.

Besides the gold and silver there are also bank-notes. By the latest return the notes issued by the Bank of England are about fifty millions, of which nearly fifteen millions are held by the Bank itself. In normal times the notes of the Bank of England are also legal tender except by the Bank itself. The Bank must on demand give gold for its notes. There are also other bank-notes, issued by other banks, but all these notes also are merely promises to pay gold on demand. Gold is the foundation of the whole system.

In ordinary times bank-notes, silver, and bronze circulate side by side with gold at their full nominal value, and there is never any hesitation in accepting any of them. The proportion of gold, silver, and notes in circulation simply depends on the convenience of the people. People prefer a bank-note to a large sum of gold, and, on the other hand,

for certain payments the small change of token money is required. No one thinks of the fact that the silver in twenty shillings is not worth the gold in half-a-sovereign, or that the material value of the bank-note is that of the paper on which it is printed.

It may perhaps be thought that the bank-notes simply represent so much gold retained in the banks, but even of the Bank of England this is not true. The notes issued are in excess of the total gold held by the Bank, and this gold has a very much heavier burden to bear than simply securing the convertibility of the notes on demand.

But before looking at this other burden it may be well to state how it comes that coins and notes can for an indefinite period, if issued under proper conditions, maintain a value so much above their material value. The answer is simply that the value is a scarcity value. In other words, everything depends on the *principle of limitation*. If silver were coined in unlimited quantities, the metallic and the nominal value would coincide. Accordingly, the coinage of silver is limited. The printing of bank-notes is also placed under stringent limitations. Although in essence a bank-note is simply a promise to pay, bankers are not allowed to make as many of such promises as they please. In every country the issue of bank-notes is placed under very stringent limitations, though the nature of these limitations varies. In the normal case all these methods of limitation in practice reduce to securing *the immediate convertibility of the note*. So long as the holder of a note can get from the bank the corresponding gold, the note must keep its nominal value.

It is, however, quite clear that when we say the country is full of "money" we cannot refer to these two hundred millions or so of gold and silver coins and bank-notes. And if we mean that we have plenty of money to carry on a great war in foreign parts, and by money we mean gold, which is the only true international money, all the money that is really available is the gold in the Bank of England, which by the latest return is about thirty-two millions sterling.

The truth, of course, is not only that there is not enough money to carry on a war, but that there is not enough to carry on the trade of the country on a strictly cash basis. Under present conditions the principal means of payment is not money (whether gold or bank-notes), but cheques. Cheques are balanced against one another, and the gross total cleared at the Bankers' Clearing House for last year was over sixteen thousand millions sterling. It would have been utterly impossible for the business represented by these figures to have been carried on by means of cash (including notes).

In this country the curious thing is that whilst bank-notes are limited by a cast-iron system, with regard to cheques there is practically absolute freedom. A banker may give a cheque-book to anyone he likes, and may make any provision he thinks fit for meeting the cheques. But there is in fact a very serious limitation. In the last resort the receiver of any cheque is entitled to ask for the corresponding gold. If at any moment all the holders made such a request and insisted on payment in cash they could not get a penny in the pound. But banking, like insurance, depends on the average demands that have to be met.

In normal times the proportion of business carried on by means of cheques, as compared with actual cash, depends simply on the convenience of people. Gradually people acquire the habit of making certain kinds of payments by cheque, others by bank-notes, others by gold and token coins. They take it for granted that these different kinds of "currency" are always exchangeable at their nominal value, and not one man in a million could estimate even roughly the value of any cheque he had received if all the banks were in liquidation. Such extreme illustrations are only of service in showing how the whole of our monetary system depends on the convertibility of the different kinds. For certain cheques, *e.g.*, for the payment of wages, actual cash must be obtained—gold, silver, or bank-notes. Similarly of many retail payments. When trade is very active, a greater amount of cash is put in circulation for these

purposes. The banks must keep enough to meet these demands. So far as the home country is concerned, there ought never to be any difficulty in keeping enough of cash to meet the greatest activity in the demand.

In times of crisis, however, there is a disturbance of the normal proportions in the use of different forms of credit and different kinds of "money" (gold, notes, and tokens). In the greatest crises of the nineteenth century the notes of the Bank of England were above suspicion, and there was no run on the Bank to exchange notes for gold. On the contrary, people wanted to get more of these notes issued. It must never be forgotten that the suspension of the Bank Act simply meant that the Bank could issue more notes, and not that it ceased to give gold on demand for its notes. Suspension of the Bank Act is a matter of infinitely less importance than the stoppage of cash payment for the notes or the institution of a moratorium as regards cheques, which is in essence the same thing.

The unexampled severity of the crisis caused by the outbreak of the present war is shown by the extraordinary measures adopted to get over the immediate financial dangers. Without banking, the business of the country cannot be carried on. Barter is impossible. Universal cash transactions are equally impossible. The latest returns for the Bankers' Clearing House show that during the last two weeks the amount of the business has fallen to nearly one-half the usual amount. And yet even in these weeks the business was about £175,000,000—that is to say, settlements of monetary transactions were effected by bankers' credit to that amount. It was only natural that the outbreak of war should put a stop to a great deal of business, and some falling off in the business of banks was inevitable. And no doubt a contributory cause has been the moratorium. People who are accustomed to receive certain dividends with regularity will realise how the moratorium has diminished the number of cheques passing through the banks.

What, then, are the practical conclusions to be drawn

from this examination of the foundations of our present system? The first is that every effort should be made to preserve the convertibility of the different forms of currency. In magnitude by far the most important is the cheque. So long as the banking system remains in effective working order there is no difficulty in the interchange of the different cheques, but so long as the moratorium is taken advantage of by the banks the convertibility of the cheque into gold is partially suspended. But the essence of good banking is to be able to meet all claims on demand. That is the reason why bankers' funds must not be locked up. According to the old saying, the banker must know the difference between a bill and a mortgage. It is no use saying that if time is allowed a bank can fulfil its engagements. Investment for long periods is not banking. In banking the time of payment is the very essence of the whole business. The real meaning of a moratorium in banking is partial or temporary insolvency in the literal sense of the term. The less advantage is taken of the moratorium so much the better. It is only justifiable as a temporary measure under urgent necessity. It is injurious to the whole credit system of the country. Bank-notes are not so important as cheques, so far as the volume of monetary transactions is concerned under normal conditions, but they are of increasing importance in times of difficulty. For internal purposes they can be made compulsory legal tender, and by the mere decree of the Government they can be made inconvertible. In the great Napoleonic wars Bank of England notes were made inconvertible. The Bank was not allowed to give out gold for its notes. So long as the notes do not become depreciated—that is to say, as long as a one pound note has the same power of purchase as a sovereign—no harm is done. But all history shows that inconvertible notes do in general become depreciated. And the worst of it is that, like an insidious disease, the evil becomes deeply seated before it is discovered.

The only way of prevention of the depreciation of bank-notes is strict limitation of the issues. The surest and

safest method of limitation is immediate and easy convertibility. The new issues of one pound and ten shilling notes are made convertible at the Bank of England, but they are issued by the Treasury. It is reported that the ten shilling notes are to be issued by the Post Office. If this is the case, the provision for convertibility at the Bank of England does not seem very effective. A great mass might be scattered up and down the country before any effective demand arose for conversion at the Bank of England. But if too many are issued, in time they will be presented for conversion; and if the Bank finds it inconvenient, and is authorised by the Government, it may refuse gold, and the notes become at once in the strict sense inconvertible. In Scotland and in Ireland we have already one pound notes. In England we cannot expect that all at once people will begin to take the new notes in preference to gold. If the banking system remains sound, the same proportion of business will be done by cheques, and except by the displacement of gold in circulation there is no room for a great issue of the new notes. If too many are issued, they will be exchanged for gold or become inconvertible. No indication has been given by the Government of any principle of limitation of the new issues, or of their immediate uses. If they are used for the necessary cash payments by the State, the need for limitation is all the more pressing. It is not the immediate effect that is to be feared, but the cumulative effect of successive issues.

Fortunately in this country, since the conclusion of the Napoleonic wars, we have had no experience of the evils of depreciated currency. If people only understood that depreciation means a rise in prices, and the greater the depreciation the greater the rise in prices, they would think that depreciation ought to be avoided even at the risk of considerable inconvenience. Once the safeguard of convertibility in the strictest sense is abandoned, it is difficult to observe any effective principle of limitation. If the new notes are taken up readily in England, and if they displace gold from circulation, a large part of this gold ought

to be kept as a reserve to ensure convertibility. The Government has undertaken in these days altogether exceptional functions by way of guarantees to commerce. The first of Governmental guarantees ought to be against the depreciation of the currency. If prices are kept on the gold standard, it looks as if there would be no very excessive rise, but if prices come to be measured in inconvertible notes, there is no limit to the rise except in the limitation of the issues.*

* As shown in Chapter V., p. 95, for the first five months of war prices rose very little, but with the continued inflation of currency and credit there was a progressive rise in prices.

CHAPTER III

THE SINEWS OF WAR

(*August* 27, 1914)

Everybody knows the saying that money is the sinews of war. Everybody knows that in war a nation spends its blood and its treasure. They have a horribly clear idea of the meaning of the blood, but what do they mean by the money or the treasure?

In old times treasure meant literally gold and silver—more especially silver—which was universally the principal money before gold. The discovery was soon made that the greater the treasure so much a greater amount of the blood of the enemy could be shed. Soldiers had to be paid, and war materials purchased. Every feudal Baron knew the value of treasure as a means of shedding blood. So did every free trading city. In time, as the idea of nationality was developed, treasure came to be considered as one of the principal supports of national power. During the seventeenth and eighteenth centuries the policy of Europe was dominated by what is called the mercantile system. The real original aim of this policy was not the increase of commerce, but the increase of national power. It was taken for granted that the more money the greater the power. If any country did not itself produce the precious metals, the only way to get them was by trade. And the only way to keep them was by a favourable balance of trade. That is to say, the exports must always have a greater money value than the imports, so that this favourable balance might be paid in money. In the course of time the original end of national power was lost sight of in the means. By a confusion between wealth and money a favourable balance of trade

came to be regarded as the measure of the advantage of the foreign trade of the country. All our commercial policy was directed with this object in view. Trade with France was crippled because the balance was unfavourable; with Portugal, trade was encouraged because the balance was favourable. The original aim, however, was never lost sight of altogether. People thought that a plentiful supply of money was necessary for war. The less money the enemy could get so much the better. To keep money out of France was to weaken our traditional enemy. Adam Smith, although himself one of the strongest upholders of nationalism (and even of imperialism), shattered the idea that national power was to be obtained by a set of favourable money balances with all sorts of countries. *Inter alia*, he destroyed the notion that treasure ought to be accumulated in times of peace for purposes of war. He confirmed his reasoning by reference to the wars of his own country—the eighteenth century was full of wars—and he showed in particular that all the treasure in England, including the private plate, could not have sufficed to carry on even one of these great wars.

But if in the eighteenth century wars could not be carried on on a simple cash basis, still less is it possible in the twentieth. For certain payments gold may be necessary, hence the use of the Continental war chests, but of the total expenses only a small part can be met in gold. Are we, then, to say that money is no longer the sinews of war, just as flint-locks and smooth-bore cannon are no longer the weapons?

On the contrary, we know that at present money is looked on more and more as the sinews of war, and that the expenditure of money is a necessary preliminary and accompaniment of the spending of blood. The great national debts of the world have for the most part been accumulated in times of war. In this country we are still paying for the wars that saved Europe from Napoleon, not to mention the wars of the eighteenth century which gained (and sometimes lost) colonies and dependencies. In their origins these national

debts meant the provision of money for the actual carrying on of the wars.

In the present war everybody knows that we shall have to raise "money" by taxes and borrow "money" by loans. We are also encouraged to believe that our money power is stronger than that of the enemy, and that finance will play a great part in securing victory. But we are always thrown back on the question, "What is the money? Where is it to come from?" Probably some people have still the idea that by money we mean gold and silver, especially gold, and that hoarding gold is specially unpatriotic, because the Government wants all the gold it can lay hands on. But as a matter of fact, gold forms only a small part of modern money. The great commerce of the country is carried on not by means of metallic money, but by means of credit in various forms, especially bankers' credit that is operated on by cheques.

The term bankers' credit suggests a delightful elasticity compared with treasure in the old sense. It costs as much in labour and capital to get out of the earth an ounce of gold as it costs to get five or six tons of the best steam coal. But the banker, it seems, has only to make a judicious use of the three "R's" to make as much money as he thinks fit, and to lend it to other people just as if it were the real thing. All that is needed, it seems, is confidence. The word credit itself means belief. If people believe in the bank and the bank believes in the people the thing is done. On the outbreak of the present war the Chancellor of the Exchequer appealed to the Press to appeal to the people to keep calm, to go on trusting the banks, and the banks would pull them (and him) through. Nor was the appeal unnecessary or unreasonable. The belief side of credit is always of importance. Sometimes there is too much of it, and the awakening from the confidence is a commercial crisis. Sometimes, as on our declaration of war, there is too little, and people go to sleep and dream nightmares. Without metaphors, the outbreak of war made everybody uncertain of the future, and uncertain even of the past. New contracts were

checked, and the old were put under a moratorium. There can be little doubt that part of this uncertainty was ill-founded, as in the case of the people who began to hoard gold and food. But no doubt also, confidence was rightly shaken, and with it the credit system, and especially the banking system of the country.

But in any case, belief or confidence is only one element in bankers' credit. All this bankers' credit must rest on real wealth if it is sound. The simplest form of bankers' credit is the bank-note, and the banker must be able to meet on demand the claim for gold. The notes are based on gold. But almost any form of wealth can be melted down into bank money as an old writer has it, or can be made directly or indirectly the basis of bankers' credit. In Berlin, on the outbreak of the war, the State apparently became a kind of gigantic pawnbroker, and allowed people to get a kind of notes to half the value of almost any kind of property which they liked to pledge. Even in normal times, the banks in Germany are directly mixed up with industrial concerns, just as were the Scottish banks in their origins, *e.g.*, the British Linen. In this country, however, bankers' credit has come to be confined within more narrow limits so far as the banking proper is concerned. Yet even in this country, what is good enough banking security in times of peace is not good enough or to the same degree in time of war. Accordingly, on the outbreak of war, there is naturally and inevitably a contraction of bankers' credit. Here is the disadvantage compared with the old kind of treasure, which was real metal and not fairy gold.

But we must not rush to the extreme of supposing that all or even a considerable part of the bankers' money is fairy gold and will disappear. Bank money, like gold money, is properly a means of exchange. The banking system is part and a most essential part, of the mechanism of exchange. Production in the narrow sense cannot be carried on without exchanges of all kinds. Trade proper is part of production proper. The thing is not finally produced until it is in the hands of the consumer. Without banking in a modern

industrial country trade and production must come to a standstill—if there is a partial stoppage of the banking there is a partial stoppage of industry.

When we say that bank money, like gold, is only a medium of exchange we must remember that exchange covers practically the whole of the economic activities of the nation. We get, for example, exchanges of present values against future values, which brings under exchange all the vast fields of the investments of capital. We have the exchange of distant goods with near goods, which brings in the vast fields of foreign trade. As regards foreign trade, London is the clearing house of the world. The bill on London is the chief form of international currency.

The same economic principle applies to all kinds of money considered as media of exchange, whether they are made of bronze or silver, or gold or bits of paper. They fulfil their functions perfectly if the exchanges of services and commodities of all kinds, present and future, are effected without friction or delay. If people once begin to bargain and chaffer over the kind of money they are paid in, if they find one sort is not so easy to pass on compared with the other sorts, this means that the first sort is partially inconvertible, and as a medium of exchange has lost so much of its virtue.

The great safeguard against monetary friction is to hold fast to the principle of convertibility into gold. The London money market has gained its supremacy because, as the saying is, it is the only free market for gold.

All the world over, however, there has recently been a growth of laxity in the observance of this principle. Banknotes with us, so long as the law is kept, are absolutely secure. It is to be hoped the law will still be kept in spite of the temptations in time of war to resort to inconvertible paper as the simplest means of getting so-called emergency currency.

The other forms of bankers' credit are of the same nature as the notes, but instead of excessive regulation there is excessive freedom. The consequence is that in this country especially the economy of gold has been pushed to an extreme.

Ever since Bagehot wrote his "Lombard Street," nearly forty years ago, eminent financiers, *e.g.*, Lord Goschen, have given solemn warnings of the inadequacy of the gold reserves. It is from the banking point of view that the accumulation of treasure is still said to be of national importance. According to a recent calculation the total deposits in the British great joint-stock banks is about one thousand million pounds sterling, and against this on the most liberal estimate there is about 10 per cent. of gold. If the amount of gold were doubled it does not follow that the security of the bankers' credit would be doubled. The mere piling up of gold in the vaults of a bank is not enough. What is really wanted is the provision of means by which as the fund is depleted it is renewed. We do not want a cistern full of gold money, but a never-failing stream to draw upon. Germany in ordinary times has a much larger amount of gold in its banks than is the case in this country. Yet the deposits in the German credit banks are only about half the deposits in our joint-stock banks and the Bank of England. But if we look to the record of the imports and exports of gold we find in general that if our cistern is not half so full our flow of gold is very much stronger. In 1912, for example, to take the latest return that happens to be at hand, Germany exported some £7,000,000 of the precious metals whilst our figure was some £65,000,000. Similarly, as regards imports, Germany had some £16,000,000 to our £76,000,000. People often forget that the object of a gold reserve is to be used as occasion requires.

It is time to return to the main position. Money is still the sinews of war, because even in war, although there is much seizure of property and much enforced labour, still for the most part we have to rely on the payment for services and commodities. The money by which these payments are effected is to a great extent credit. The country with the most efficient system of credit can conduct the business side of the war in the best manner.

If there is any breakdown in the credit system, there is so far a stoppage in the exchange of real things and real services.

The process is revealed in every commercial crisis. If employers cannot as usual discount their bills or get advances from the banks they cannot pay their labour, and they cannot get their raw materials. So far as production is lessened the real power of the country is lessened. Trade is an exchange of real things; the credit is only the means. Bankers' credit that does not circulate is as useless as little *sous* in a big stocking. So far as industry is contracted, so far the taxpaying power of the country is contracted. The sinews of war are directly weakened. The longer the contraction of industry lasts, so much the more crippled also is the future. The issue of a Government loan simply means that the capital value of future revenues from taxation is anticipated.

The nation with the best system of credit can most readily carry on its trade and adapt its trade to new conditions. In this country there is no need that, with the command of the sea, our trade should be diminished to anything like the same degree as German trade, if the credit system is made to do its work properly. Adam Smith, after showing that the expenses of a great war could not be met out of accumulated treasure, showed also that they must be met out of real production. And in that way he arrived at his famous paradox—In the midst of a great war the greater part of manufactures may flourish greatly. The sinews of war will also be strengthened by the strengthening of industry.

CHAPTER IV

GERMANY'S ECONOMIC MISCALCULATIONS

(*September* 5, 1914)

I

SINCE the outbreak of war we have heard a good deal of Germany's miscalculations regarding the moral and the military strength of other nations. Germany never imagined that this country, which seemed to worship wealth, would go to war for a scrap of paper, and never imagined that Russia would strike hard and strike quickly. But the greatest of all the miscalculations of Germany, because the most far-reaching and fundamental, have been the economic. The real ultimate aim of German economic policy is now perfectly clear to the most peace-loving Briton. The "infamous" proposal to take the colonies of France and the actual invasion of Belgium show clearly enough that if occasion had offered the British Empire would have been open to a similar attack. We may go further, and say that the absorption of Holland and Belgium and the weakening of France are only steps on the way to the break-up and appropriation of the British Empire, or at least of all such parts as could be comfortably swallowed.

Fortunately Germany has revealed her policy too soon, probably driven by dynastic and military influences. There can be little doubt that after this warning—if only disaster is escaped this time—the enormous resources of the British Empire will be so organised as to make any future attack by Germany ridiculous. Consequent on the exhaustion of the war, and the increase of national antipathies, the economic development of Germany must be arrested, whilst that of the British Empire will be placed on a higher stage. That is the fatal economic mistake of Germany.

The nature and the consequences of this mistake may be made clear by looking at the general trend of German economic progress for the last hundred years, and especially since the great Franco-German war. The dominating ideas of this policy have been forcibly expressed in the great work by Friedrich List on the "National System of Political Economy," of which there is happily an excellent English translation. Seeing that List died in the year of the repeal of our Corn Laws (1846), and that his book was completed about two years earlier, it may be thought that the policy of the "National System" must by this time be out of date. But in fact the policy laid down by List for the development of the German Empire is the policy which in all essentials has dominated, and still dominates, German statesmanship. After all, the great ideas by which nations are ruled cannot be changed like the fashions of a garment, and a world-policy to be effective must be of slow growth. And above all other nations, as List observed, the Germans are subject to the rule of theories. "Germany developed herself in a totally different way from other nations. Elsewhere high mental culture grew out of the evolution of the material powers of production, whilst in Germany the growth of the material powers of production was the outcome chiefly of an antecedent intellectual development." Even in the eighteenth century he shows that the lead was taken by the German State Governments in the application of ideas. "Hence at the present day (1844)," concludes List, "the whole culture of the Germans is theoretical. . . . For the moment the Germans are in the position of an individual who, having been formerly deprived of the use of his limbs, first learned theoretically the arts of standing and walking, eating and drinking, of laughing and weeping, and then only proceeded to put them into practice." Not that the Germans have been governed by ideas to the exclusion of the teachings of history and experience. On the contrary, especially in economics, they emphasised the fundamental importance of the historical method. Their economists supposed that they had replaced the theoretical system of Adam Smith

(which they called by the awful name of "Smitianismus") by a positive science founded on history and facts. They were wrong about Adam Smith, who more than any writer (German or other) referred all his theories to the test of experience; but this is a digression.

The first part of List's book is entitled the "History," and deals with the economic development of the principal nations. The final chapter of this part ("The Teachings of History") makes a fitting transition to the leading ideas of the remainder. The main conclusions are that undeveloped nations begin with free trade with the more developed; in the second stage they themselves promote the growth of manufactures, fisheries, and foreign trade by means of commercial restrictions. In the last stage, after reaching the highest degree of wealth and power, they gradually revert to the principles of free trade and of unrestricted competition in the home as well as in foreign markets, so that their manufacturers may be preserved from indolence and stimulated to retain the supremacy they have acquired. In the first stage (he says) are Spain and others; in the second, Germany and the United States; France is on the border between the second and the final stage of development; but Great Britain alone at the present time (1844) has reached it. List boldly carried these historical ideas to their logical conclusion. He agreed with Cobden and the Manchester school that the adoption of free trade by England would be of advantage to her manufacturers. He went so far as to say that England in her own interest should have adopted free trade and repealed the Corn Laws after 1815. England had a monopoly of manufactures, and needed no protection.

If other nations desired to diminish or share the unquestioned commercial supremacy of Britain they must adopt the same methods—that is to say, the methods which England had adopted at a similar stage of development. They must remember that they were only at the second stage, and they must encourage the development of self-sufficing industries by a national protective system. They

must follow in the footsteps of England. England had only reached the final independent stage after a long period of development under a very strong protective system of a very elaborate kind. England had aimed at the establishment of a monopoly for her manufactures over the widest possible area, and with this object in view all her great wars had been waged—*i.e.*, for the acquisition of new markets and the retention of the old.

In the application of these ideas to the case of Germany, List came to some very practical conclusions that are of special interest at the present time. The last book in the "National System" (the "Politics") lays down the lines which have been followed, and are being followed, in the actual development of German commercial policy. No doubt there are some differences in detail owing to changes in conditions, but anyone who reads List will be astonished at the way in which his ideas have actually been realised by Germany, and are still the basis of the German forward policy. The guiding clue is imitation of England—that is to say, England in her protectionist stage. "England owes her immense colonial possessions solely to her surpassing manufacturing power. If the other European nations wish also to partake of the profitable business of cultivating waste territories, and civilising barbarous nations, or nations once civilised that have again been sunk in barbarism, they must commence with the development of their own internal manufacturing powers, of their mercantile marine, and of their naval power." This advice is tendered specially to Germany. "If any nation whatever is qualified for the establishment of a national manufacturing power it is Germany." Seventy years ago List pointed to German superiority in education and in administration, to the aptitudes of her people for industry and trade, to her skill in inventions, and to the vast natural resources of her territories in agricultural and mineral wealth. To give full scope to these mental and material productive forces, and become a great manufacturing power with all its consequences, Germany must adopt, as England had done, a

protective system. She must learn to make for herself all important manufactures, and not be content to receive them, in exchange for grain and timber, from Britain. But this was only the beginning. Germany must directly import from tropical countries the produce she requires, and pay for it with her own goods. She must carry on this trade in her own ships; she must protect these ships with her own flag and her own navy. The first step is to make Germany strong in itself by manufactures, railways, waterways, and the scientific organisation of industry. She must improve on the English example with greater knowledge, and profit by England's experience.

Within the German Zollverein—the great Customs Union of which List himself (1818) was the chief originator, with its internal free trade and its external protection--within this great confederation must be included all German maritime territories, and also Holland and Belgium. The greater Germany is also to include Switzerland. In fact, we have in List all the ideas of Pan-Germanism with a wide interpretation of the word "German." The views of List on Holland are of special interest at the present time.

"From a national point of view we say and maintain that Holland is in reference to its geographical position, as well as in respect to its commercial and industrial circumstances, and to the origin and language of its inhabitants, a German province, which has been separated from Germany at a period of German national disunion, without whose reincorporation in the German Union, Germany may be compared to a house the door of which belongs to a stranger. Holland belongs as much to Germany as Brittany and Normandy belong to France, and so long as Holland is determined to constitute an independent kingdom of her own, Germany can as little attain independence and power as France would have been enabled to attain these if those provinces had remained in the hands of the English."

If we look to the development of German economic policy, and to the actual condition of Germany before the outbreak of the war, we see at once a remarkable realisation of List's ideas. In Europe, Germany has become second only to Britain in manufacturing power and in shipping, and at

least equal in the organisation of the internal means of communication and of industry generally. By all the usual tests of material prosperity Germany has made astonishing progress since the last great war. This progress in wealth has been accompanied with similar progress in national power. In fact, the production of wealth and its distribution have been so organised as to promote the military and naval power of the country. The railways are largely strategic, and agriculture has been fostered with the definite aim of independence as regards the main food supplies. The export of capital to foreign States has been discouraged so that the national industries might first be strengthened. A check has been imposed on the emigration of the living capital, and the population has shown a remarkable increase.

But, after all, these are only the preliminary stages in the advance to world power. From the Germanic point of view the complete ideal of List has not yet been realised. Further growth of power is conditioned by an extension of territory or of dominant political influence. Seventy years ago List compared Turkey to a corpse that might be held up by the support of the living, and he put in the same class the Persians, the Chinese and Hindoos, and all other Asiatic peoples. What fields could be more suitable for the application of the German powers of expansion? The great obstacle was the British Empire.

List also contended that Germany "should try whether and how German colonies can be founded in Australia, New Zealand, or in other islands of Australasia. German emigrants to the United States and other countries in the next generation were lost for ever to the mother country. For the extension of national power Germany must have her own Germanic settlements. The right of the English to the Continent of Australia on the principle of first occupancy was as absurd as the right claimed by the Popes over the partition of the New World.

Can there be any doubt that these ideas of List have been and are the ruling ideas in German economic policy? Germany aims at being a world Power—the greatest of

world Powers. But everywhere her territorial expansion is checked by Britain. In Africa, Asia, South-Eastern Europe, and Australasia, Britain bars the way to German aspirations. Even in Northern Europe, Britain stands in the way of the Germanic absorption of Holland and Belgium. The galling thing to Germany is that she considers herself in all the essentials of national power superior to Britain. Britain obtained her world Empire by war followed by the monopoly of trade. If, then, Germany is stronger in war and more capable in trade, why should she not imitate Britain and displace Britain from her supremacy?

But in the endeavour to take this last step towards world power at the expense of the British Empire, Germany has made the fatal miscalculation of striking too soon. She ought to have pursued longer the methods of peaceful penetration, and worn longer the mask of the love of peace. Now that it is made plain to every inhabitant of the British Empire what is the real aim of German policy, it will be only natural if every method is adopted to thwart that policy. Already we hear of the war on German trade, and this policy, once begun, cannot be broken off on the conclusion of peace. The economic development of Germany will be arrested and even thrown back.

CHAPTER V

GERMANY'S ECONOMIC MISCALCULATIONS

(*September* 12, 1914)

II

WE have become so accustomed in recent years to be referred to Germany for the latest word in all the sciences and in all the business of life, that we can hardly believe our eyes when we see Germany making mistakes of the first magnitude. Even now (such is our habit) we find complaints in some of our own journals that our banks do not follow the German methods in the present crisis. The object of this second article is to supplement the ancient history of the first by the corresponding history of the present generation, and the corresponding application to the immediate future. In the current number of the *Royal Statistical Journal* is published a paper, read by Mr. Edgar Crammond last June, on the "Economic Relations of the British and German Empires," with the discussion that followed, in which the leading experts in London took part. Throughout we find the saving clause recurring—"in the absence of war." It is interesting to compare this probable forecast, made a few weeks before the outbreak of hostilities, under the expectation of a long continuance of peace, with the actual and probable results of the disturbance caused by the war. The contrast brings out very clearly the fatal economic miscalculations made by Germany in her policy of aggression.

To begin with, we may compare Germany with the United Kingdom, which of course is a very different thing from comparing Empire with Empire. With this limitation, since the great war of 1870–71, and especially since the accession of the Kaiser in 1888, the comparison of economic progress by

the method of percentages seems greatly in favour of Germany, and even the absolute returns for important tests are also favourable.

Take first the growth in population. Germany since 1872 has increased by 57 per cent. as compared with our own 42 per cent. The absolute result is that Germany by the census of 1910 had about sixty-five millions against our forty-five millions in 1911. The birth-rate in Germany in 1911 was 29·5 per thousand against our 24·4. Emigration from Germany had on balance almost vanished whilst ours was increasing. It is, however, noteworthy that the death-rate is considerably lower in the United Kingdom, which is the more remarkable inasmuch as Germany has proportionately a much larger non-urban population. It may be observed, in passing, that the death-rate is one of the best summary tests of the economic welfare of the people. On balance the population of Germany is at present some twenty millions larger than ours, and the disparity would increase every year if the present rates had been maintained.

The distribution of the employments of the people between agricultural and non-agricultural is of special importance. In recent years in Germany agriculture (in the widest sense) has been fostered both by the exclusion of foreign competition, and by the adoption of scientific methods and more intensive cultivation. And yet, in spite of all this encouragement and the corresponding increase in agricultural production, there has been a steady increase in the importation of food stuffs. Since 1887 the increase in the imports of foods, beverages, animals, etc., has been more than threefold, and in 1912 the absolute amount was about £160,000,000. There has been a corresponding steady increase in the percentage of the non-agricultural population. Germany has, in fact, become a great manufacturing Power, and she can only maintain her increasing population by increasing importation of food. In the United Kingdom, on the other hand, a point has now been reached at which it will probably be more advantageous to devote more capital and labour to the land. Even as it is, Mr. Rew has estimated

we raise (apart from sugar and beverages) more than half our total food requirements. The room for agricultural expansion in Germany is not so great as it was, or conversely Germany has more need of manufacturing expansion.

The increase in the manufacturing power of Germany is also shown by the great increase in the production of coal and steel, and in the growth of particular industries, *e.g.*, the textiles. Germany has a mileage of railways about 50 per cent. more than the United Kingdom constructed at a capital cost of nearly 30 per cent. less. During the last twenty years the gross receipts of the German railways have increased by 150 per cent. as compared with an increase in the United Kingdom of some 75 per cent. In Germany the inland waterways are nearly double the mileage of the navigable waterways of the United Kingdom, though it should be remembered that our coastwise traffic is very much greater. In Germany the development of the internal means of communication (notably railways) has been under the direction of the State. As a consequence not only have military requirements always been considered, but attention has been paid to the general distribution of industry. Railways and their branches have been constructed so as to put the agricultural East more on a footing with the manufacturing West. It is possible that with less favour to agriculture Germany would by this time have been even to a greater extent a manufacturing Power.

The principal result of this comparison, not to mention the development of shipbuilding and navigation, is that Germany has become more and more dependent on foreign trade for her future expansion. No possible development of her agricultural industries could suffice to carry off her increasing manufactures. Even if the agriculturists could manage to support the increasing city population this could only be done at a greatly increasing cost, which of itself would check the manufacturing expansion. At her present stage of development foreign trade has become as vital to Germany as to the United Kingdom.

That this is no theoretical conclusion may be shown by the

actual increase in recent years of German foreign trade. From the accession of the Kaiser (1888) to 1912 the imports into Germany for home consumption increased absolutely by some £370,000,000, whilst in the United Kingdom the increase in the corresponding imports was only some £300,000,000. A similar increase (though relatively not so great) is shown in the German exports of home products. The result of the comparisons as regards foreign trade is that, taking imports and exports together (and excluding re-exports), Germany has already nearly caught up the United Kingdom, and threatened, had peace continued, to get in front in the course of the next five or six years.

This general dependence of Germany on foreign trade acquires still greater significance if we look to the trade with the principal countries. Nearly 40 per cent. of the foreign trade of Germany before the war was with her present enemies—Russia, France, and the British Empire. Since the beginning of the present century the amount of the foreign trade of Germany with Russia and with France has about doubled. These two countries now account for about a fifth of Germany's foreign trade.

The trade of Germany with the British Empire is nearly as great as her trade with Russia and France combined. Some features of the trade relations of Germany with the British Empire are of special interest. In the first place the United Kingdom is a more important market to Germany than the latter is to the United Kingdom. That is to say, Germany sells to us more than we sell to Germany. This apparently unfavourable balance is settled largely by the indirect trade of Germany and by her imports from the rest of the British Empire.

The economic importance of the British Empire to Germany becomes still more clear if we look to the nature of the trade. Germany obtains from the British Empire an increasing amount of food and raw materials that are vital to her industries. Even this enumeration does not complete the advantages that Germany derived until the outbreak of

the war from the British Empire. The new countries of the world, both in the British Empire and elsewhere, have been largely developed by British capital. Germany in comparison has used her capital to a much greater extent at home. But Germany has shared with the rest of the world the advantages of the development of these new countries. The growth of German manufacturing power has been largely dependent on the external investments of British capital. If as the result of a prolonged war the foreign investments of British capital are much lessened, the indirect loss of Germany will be very great.

The general result is that at the present stage of her economic development peace was of special importance to Germany, and most of all peace with the British Empire. Every year of peace increased the economic and the military power of Germany. On the other hand, with the continuance of peace the effective organisation of the British Empire was being deferred from year to year. The chief result to Germany of the great Franco-German war was the consolidation of the States that now form the German Empire. It is quite possible that one of the principal results of the present war will be a corresponding consolidation of the British Empire.

Before the war Germany had already acquired a Colonial Empire of over a million square miles in area, or about six times the area of Continental Germany. It is true the European population of these colonies was only about one-fortieth of a million, but there were about twelve millions of natives. It is said that Togoland (already lost) was the only unit that was self-supporting. Germany had quite enough of territory to practise the art of colonial government and development. It is obvious that as regards colonial expansion the waiting policy was the best for Germany. Time also might have enabled Germany to realise that her military morality was not suited to the extension of overseas dominion. What State in the British Empire, if the free choice were offered to-morrow, would put itself under German militarism? Not one, as the present crisis shows,

but would resist the transfer to the utmost. Not one would kill Britain to make Germany king.

The German military morality is indeed altogether unsuitable for any sound economic system, as Germany will find to her cost. The wages of nations, like the wages of workers, are higher in proportion to the trust imposed in them. Good faith is an essential to economic as good discipline is to military efficiency. National discredit spreads to the individuals that make up a nation. The German statesmen appear not only to have paid no regard to the far-off interest that will be exacted by the civilised world for their barbarism in Belgium, but they do not appear to have realised the immediate burdens that the war will throw on the German people and the reaction of the economic depression on their military power.

We do not obtain from German sources much information, decorated or undecorated, on the economic effects of the war in Germany itself. But enough has leaked through to show, as might have been anticipated, that the stoppage of foreign trade has been associated with a large increase in unemployment in spite of the mass of labour diverted to the war. It is of course the poor who are already suffering most severely. A gigantic scheme of State insurance against unemployment is now being organised, says the Socialist *Vorwärts*, under the spur of necessity. Under present conditions insurance is hardly the right word. But the fact remains that the unemployed and their dependants and the non-combatants and their dependants must be supported, and if wages cease the State must step in. In the meantime the stoppage of food imports must also raise prices. The Government has adopted the usual and simple plan of fixing prices, but it is difficult to see how the rates can be maintained in the face of the enormous issues of inconvertible notes, which it is reported in the *Economist* are already depreciated over 20 per cent. even in Holland. It is said that the various municipalities are to advance loans on all kinds of securities. These advances must also be made in paper. To meet the scarcity of money notes are to be issued

of the nominal value of a mark and half mark (shilling and sixpence). The only possible effect of these measures must be a further rise in prices. We used to be asked to admire the mass of the deposits in the German savings banks, which before the war were estimated at about a thousand millions sterling. A time of war is a time of need. How are the savings to be withdrawn? The funds are very generally invested in mortgages on lands and houses, mostly for long periods. The only alternative is more inconvertible notes, and the savings must be paid out in depreciated paper. How long can the German people be brought to bear the sufferings that underlie this contraction of employment and expansion in prices? Adam Smith said that in his day, amongst the civilised peoples of Europe, it was commonly computed that a nation could not support more than one-hundredth part of its inhabitants as soldiers without being ruined. Since his day the powers of production have increased, and no doubt a greater surplus is available for the luxury or the necessity of war. But the percentage of those employed in war has also risen sevenfold, the expense is many times greater, and economic exhaustion must come all the sooner, and far sooner in Germany than in the British Empire.

CHAPTER VI

BRITISH CREDIT AND WAR FINANCE.

(*September* 28, 1914)

THE Chancellor of the Exchequer called attention recently to the importance of the financial strength of this country as affecting the conduct and the final result of the war. He said that in this matter of finance it is not the first hundred millions, but the last, that counts. Germany might get the first hundred as easily as Britain, but Britain had far greater staying power. Even in war finance it is better to think in millions rather than in hundreds of millions. Germany is finding at this very time that even the first hundred millions is not an easy matter, and we are still proceeding with tentative borrowings for short periods. As regards the last hundred millions, the facility with which it may be obtained will be conditioned by the numbers of the previous millions, and by the methods by which they have been obtained.

The Chancellor illustrated his point by reference to the great Napoleonic wars. He said that the strongest of the allied forces against Napoleon was the power of British finance. He did not say that the management of British finance during that period was, to put it shortly, very bad. Such was the opinion of Ricardo, who was the leading authority of the time both in the theory and in the practice of finance. In business ability and in the amassing of a large fortune he left his contemporaries of the Stock Exchange far behind; as an economist in money taxation and finance his reputation is second to none. Such also was the opinion of Mr. Gladstone, as expressed in his great Budget speech of 1853. Mr. Gladstone's opinion is of peculiar interest at the present time. The year after the end of the war (1816)

the amount of the National Debt was 816 millions, and Mr. Gladstone emphatically stated that "our debt need not at this moment (1853) have existed if there had been resolution enough to submit to the Income-tax at an earlier period of the war." He showed that from 1806 to 1815, during which period the income-tax was in force, the country actually raised seven millions sterling a year more than the charge of the Government and the charge of the war to boot! This yearly surplus (apart from the interest on debt) of revenue over expenditure was ascribed to the productivity of the income-tax. Mr. Gladstone went on to show that a fiscal reserve is not one whit less important than an Army Reserve or a Navy Reserve, and he found such a fiscal reserve in the income-tax, "with which, judiciously employed," he said, "you may again, if need be, defy the world." Unfortunately, the income-tax has been raised recently in times of peace to what used to be regarded as a war level, and its productivity has been diminished by abatements which Mr. Gladstone would never have admitted on the ground that they would destroy the "efficacy of this great engine."

This extraordinary misadventure of the accumulation of a great addition to the National Debt when the revenues (thanks to the income-tax) were so much in excess of expenditure was due to popular delusions shared by the Government about the necessity of keeping up the credit of the country. It is not necessary to tell again the story of the mismanagement of the public credit. In the Napoleonic wars the tax-paying power of the country was not increased by the Government's attempts to bolster up its credit by a ridiculous sinking fund. It was cotton, not credit, that saved the situation; or more generally the manufacturing and trading power of the country.

The present financial position is certainly the most curious that was ever experienced in this country. It may be worth while to try to explain the essential features of the situation with a minimum of technical phraseology, but it is impossible to write of any monetary crisis without some reference to

the Bank of England rate. To tell the full meaning of the Bank rate, and the causes and the interpretation of its movements, would require a book and a Bagehot to write it. The Bank rate may be taken as representative of the rate of interest charged for money for short periods on approved banking security. Of course there are endless variations in the kinds and conditions of loans of money, but as a rule with a low Bank rate other forms of interest are lower than they would be otherwise, and conversely. Apart from Governmental intervention, the rate of interest depends on the demand and supply of loanable money. In the prolonged depression due to falling prices that reached their lowest twenty years ago, the Bank rate remained at 2 per cent. for two years, 1894-95. On the other hand, we find that in years of crisis, when everyone wants money, the rate rises, it may be, even to 10 per cent. Ten per cent. may be said to mark a very high financial fever. In the great crisis of 1866, which began through the failure of one great financial house, the Bank rate was actually 10 per cent. for ninety-six days, and it was 7 or 8 per cent. for another ninety-six days. In the Baring difficulty (1890), in which a crisis was evaded by combined action on the part of the banks, the Bank rate only reached 6 per cent., but in the American crisis of 1907 the rate rose to 7 per cent. Generally it may be said that a high Bank rate is a sure sign of a great disturbance of credit. The Bank of England rate is regarded as one of the best signs of the state of credit, not only in London, but all the world over. If there is no great rise in the Bank rate (as in 1890) most people think that any threat of financial difficulty has been neutralised by being taken in time.

On the outbreak of the present war the Bank rate promptly rose to the occasion. For the first time since 1866 it rose to 10 per cent. It rose to 10 per cent. on Saturday, August 1. But there the analogy with 1866 broke down. It only remained at 10 per cent. during the prolonged Bank Holiday. On Thursday it was down to 6 per cent., and on Saturday, August 8, to 5 per cent., and in spite of the war it has

remained at 5 per cent. ever since, and a reduction is expected. And yet last year, in the height of peace, the rate was 4½ per cent.; and 5 per cent. is nothing unusual.

How then was the crisis got over so quickly? Or is the Bank rate no longer the measure of the state of credit? The answer is that the crisis is not over, but that the Bank rate has ceased to be a register of the crisis. The reason is that in former crises there was a minimum of Governmental assistance and intervention, whilst in the present crisis the influence of the Government has been overpowering.

According to the old explanation, a crisis arises when a number of merchants have, or expect they may have, a difficulty in meeting their engagements. It is this difficulty that makes the strain on credit, and causes the exceptional demand for money. But last August the crisis was promptly stifled by the Government simply saying in the extended language of the moratorium, "Don't meet your engagements." Postponement, of course, was the word, but in a crisis postponement is everything.

This measure did not exhaust the prudent benevolence of the Government. Money was wanted, therefore the Government printed more money. One pound notes and ten shilling notes were issued by the Treasury, and postal orders for much smaller sums were made legal tender. By the moratorium any bank that liked need not pay out money on deposit or current account, but if it wished it could borrow some of the new paper. By a later device the banks need not even take a loan of the notes, but could obtain a certificate to the amount they required, and only pay when the money was really used.

Nor was this all. The Government directed the Bank of England to discount approved pre-moratorium bills, and guaranteed any loss. And here also by a later amendment the guarantee was made more effective. Not content with these encouragements to trade, the Government undertook a scheme of marine insurance. When the Government had shown the way, and the Navy had shown that it was a Fleet

very much in being, the ordinary insurance people began to take war risks.

When so much was done for banking and for the high finance of trade, no wonder that other interests began to think they ought to have a share in Governmental assistance, especially if they could show that public credit was apparently involved with their particular interests. A demand has been made on behalf of the Stock Exchange that the Government should guarantee the banks against any loss by their loans on Stock Exchange securities. In the meantime it appears the banks cannot legally force sales of securities till after the war. As yet this demand for public assistance has not been granted, and it is to be hoped that the banks are not so much committed that they cannot help themselves. Banking business ought not to have been conducted on the supposition that European peace would never be broken after all the warnings of recent years. The London Stock Exchange is itself trying to save the situation by fixing prices for trustee and similar securities. This action is to be commended if it is intended to be an emergency measure, taken to facilitate the resumption later on of ordinary business. If, however, the intention is to keep up the price of Consols so as to facilitate new issues it may be good form, but it is not good business even for the Government. The price of Consols must be governed by the rate of interest, and the rate of interest cannot be fixed by any recommendation of the Stock Exchange. Suppose, however, that for the time the price of Consols is kept up, or even rises, and that the Government is able to borrow the first hundred millions at 70, when the natural market price would be perhaps 65. In time the market price must prevail, and the next hundred millions in competition with other investments may have to be made at the market rate for similar securities. When the Chancellor of the Exchequer comes to that last hundred millions he may find that the continued fall in Consols has created a prejudice against that form of security, and the issue may be made even below the true market rate. The continuous

fall in Consols during recent years has shown that the premier security is subject to the action of general economic forces.

The credit of the British Government is no doubt greater than the credit of Germany, but it is not unlimited. If it is used for any one purpose there is so much less for other purposes. The ultimate basis of Governmental credit is the power of taxation. The borrowing power of the Government would be so much the greater but for the heavy increases in taxation for social reforms. How much will the recent guarantees given to the Bank of England cost the nation? In other words, how much will they add to the National Debt? The last calculation of the *Economist* is thirty millions. The interest on this sum will be at least a million. That is to say, the country will have to pay a million a year in taxation in perpetuity.

The issue of Treasury notes, of which by the latest return over twenty-seven millions are outstanding, is also another drain on the national credit. Like other notes, they are promises to pay gold on demand. The convertibility of these notes depends on the adequacy of the gold reserve that is kept for the purpose. Yet, because the Government has earmarked some 10 per cent. of gold as a reserve, complaints are made that the resources of the Bank of England are so far lessened, and that the credit of the Government is in itself sufficient security. The credit of the Government can no more provide gold than it can provide steam coal if the mineral is not there. The odd thing about these emergency notes is that, though money is said to be abundant, as shown by the low discount rates, the issue of these notes goes on increasing.

This inflation of the currency will raise prices or keep prices above the level they would otherwise attain. But so far as prices are unduly raised the expenditure on war is raised, and more debt must be incurred. When the inevitable fall in prices comes the burden of the debt will be so much the greater. Again the Napoleonic period is instructive. Prices rose through the excessive issues of

Bank of England notes; no doubt prices rose from other causes also, but this cause added so much more to the rise. The high prices increased the nominal amount of the debt at the time and its real burden after.

The object of this survey is not to dispute the necessity of emergency action to support the banking system of the country, or to criticise the measures actually taken. The crisis was altogether unprecedented, and even to grasp all the essential facts would have taxed the powers of Goschen and Gladstone combined. But it needs no great financial genius to show that emergency measures should be limited as much as possible.

CHAPTER VII

ECONOMIC PRESSURE AND THE LENGTH OF THE WAR

(*October* 10, 1914)

PREFATORY NOTE

[IN the first sentence of this article it is carefully stated that the forecast is founded on economic considerations alone and also under certain assumptions as regards the military and political situation that at the time seemed reasonable in the way of probability. These conditions, however, were not realised. The British Navy no doubt kept command of the sea as regards naval power, but even after three years the blockade of Germany has not been made completely effective. There can be little doubt that if we had made our blockade as ruthless as Germany would have done in like case the economic pressure would have succeeded. Not only, however, were many open doors left through neutral territories, but Germany over-ran and exploited new areas of supply. Germany left the barest minimum of subsistence to her conquered provinces and exacted also the maximum of economic work from their labour and capital. The economic pressure of Britain and her allies was never fully applied—far from it. And yet, imperfect as was the application of the pressure and after making all allowances for neutrality and plunder, it is astonishing how the Central Powers have endured. As Mr. Gerard has forcibly reminded us, the German is naturally a gross feeder—a seven meals a day gormandiser. He is also a lover of beer and skittles, and modern music and other pleasures. Before the war even his own Jeremiahs lamented the materialisation of the old German spirit. And yet the Germans have fasted from all

but sin, and lived on substitutes during three winters. If their physical endurance has been wonderful, their psychological endurance from the British standpoint has been still more wonderful. The best educated race in the world has continued to tolerate a military despotism long after the hope of a short and glorious war had vanished. Russia made a revolution—though the Russian peasant was supposed to be a Tsar worshipper far more than the German is a Kaiser worshipper. Even Greece at last expelled her *Graeculus esuriens* Constantine. But Germany has remained loyal to the Emperor and even to the Crown Prince, and has kept alive the spirit of loyalty even in the varied races of the other Central Powers. Not only has Germany resisted the economic pressure of semi-starvation, but has made good the loss of raw materials which we were assured were absolutely essential both for industry and for war. The record is extraordinary. Perhaps in the end the reaction also may be as extraordinary as a geological catastrophe due to the cumulative effect of prolonged pressure.]

The following estimate of the probable length of the war is based on economic considerations only, and in order to see their full force and to get rid of complications it is necessary to make certain assumptions as regards the general situation, military and political. Let it be assumed first that the British Navy continues to keep the command of the sea; and, next, that the general result of the military operations during the winter is what the Kaiser might condescend to call a draw. That is to say, let it be assumed that the Allies are able in the East and the West to drive the Germans within their own borders, but no more. Such a supposition does not seem too optimistic. As regards France, the German apology for the invasion of Belgium was the alleged necessity of speed. On their own showing, Paris was not to be taken except with a rush. An invasion of Russia in winter need not be considered. The chance of the occupation of the rest of Belgium may be balanced by the chance of

the intervention of Italy or Denmark. On the whole, if the Kaiser in the course of the winter can claim a draw he will do well, so far as the military situation is concerned. It might be supposed that such a concentration of the forces of Germany would lead to a defensive war that might be prolonged indefinitely, and that in this way the military draw would end practically in a political draw and the re-establishment of the *status quo ante bellum*. A political draw of this kind would, of course, to the Allies be a severe defeat. But before such a defeat can be accepted economic pressure will come in with increasing force.

Under the assumption of a military draw, and Germany for the Germans being the order of the day, let us look at the effects of this economic pressure. The first rough estimate seems favourable to Germany. For a long time Germany has set herself to become self-supporting as regards food supplies and the necessaries of life. Agriculture has been encouraged, and the production from the soil has been greatly increased. Since the last great war the arable land has increased, and the yield per acre has increased much more. There is also great variety in the products. In potatoes and sugar Germany produces more than any other nation, and her production of rye and of oats is more than double her production of wheat, and of barley is nearly as great. But in spite of this great increase in production German agriculture cannot in normal times satisfy the home demands, and there has been a steady increase in the import of cereals. As regards animals for food, the growth has not kept pace with that of population, and the imports would be much larger but for restrictive legislation. Large quantities of fish, both salt and fresh, are also imported. In 1912 the total value imported of foods, beverages, animals, etc., was over 160 million pounds, which was three times the amount imported a quarter of a century before. As also indicating the importance of the food, etc., imports, it may be observed that this aggregate is about 30 per cent. of the total imports.

After making all allowances for importation through

neutral countries, it is plain that this foreign supply must be seriously checked. Some falling off in the production of foods is also likely to take place in Germany itself. Owing to the check on the import of food stuffs for animals (bran, etc.), the stock must be reduced, and already it was insufficient. More and more in recent years agricultural industry (in the widest sense) has been conducted on intensive and scientific methods. If a large part of the skilled labour is withdrawn for the war, the effect must be felt in the net product. Old men, women, and children cannot keep up to the same extent the agricultural product. That is one of the first penalties of a nation in arms. As with labour, so with capital. Transport, a vital requirement in agriculture, is crippled by the demands made by war on the railways and horses. Credit is dislocated, and the land banks, with other institutions, must suffer.

Not only will the aggregate food supply be less, but in times of war there is a much greater wastage, so that there is a less real surplus available for the non-combatant population. But even the non-combatants must be supplied with a sufficiency of the necessaries of life. This term "necessaries" is, however, one of the most elastic in economics. Besides the foods necessary to keep body and soul together, there are other so-called "conventional" necessaries that are required to make life endurable—*e.g.*, fuel, clothing, tea and coffee, and in Germany beer. A certain amount of substitution *inter se* is no doubt possible even in absolute necessaries—*e.g.*, potato flour for wheaten or rye flour, and so on—but from the very meaning of the term there is no substitute for a general shortage of "necessaries." With regard to the conventional necessaries, it is also a well-established fact in statistics that people, if left to themselves, curtail the real necessaries before they curtail the conventional secondary necessaries to which they have become accustomed, not to say enslaved. Tea will be preferred to bread, and in some cases tobacco to either.

The general conclusion is that the shortage of "necessaries" (in both senses of the term) must be accompanied in Germany

by increasing discomfort or strain, even if, as in a besieged fortress, all the supplies were distributed in rations adjusted by military authority on an equitable basis. It is, however, quite clear that no Government could at once undertake to dole out rations to a population of over sixty-five millions. The unemployed and their dependants must, of course, in some way be provided for, but even in their case the relief may be given in the form of money, and not in actual food, etc. And in ordinary cases, as regards the great mass of consumable commodities, the distribution of the supplies within this huge fortress will take place simply according to the money power possessed by the different individuals, families, and classes.

This reliance on money as the great agent in distribution brings in very great difficulties that are not apparent in times of peace. It is not so much the absolute shortage that has to be taken account of as the distribution of the lessened supplies according to the money power of the consumers. This distinction is of vital importance. To say that Germany has a sufficiency per head of population is one thing; it is quite another thing if the distribution is effected by means of purchase and sale.

The natural result of a shortage in any necessary is a rise in price altogether out of proportion to the deficiency. In his "History of Prices," Tooke showed that a deficiency of one-sixth in the production of corn in this country, even if somewhat relieved by imports, has sometimes raised the price to double the average; and he said that a deficiency in the crops of one-third, without any surplus from former years or any chance of imports, might raise the price five, six, or even ten fold. As a matter of fact, in this country in the Napoleonic wars the price of wheat rose to over £6 per quarter. In Germany the rise in the prices of food stuffs has already begun to excite alarm, and a demand is made that prices should be fixed by authority where this has not already been done. But simple as this method seems, it is difficult to carry out in practice, and can only be applied at all in a few cases. If the prices are kept low, then there is no check

so far on ordinary consumption; and there is no effective means of preventing re-sales by individuals above the Governmental price, if limits are placed on the amounts given to each applicant. Again, the Governmental low prices would check supplies, by home production or imports, just when the supplies ought to be stimulated. History shows that, except in very simple cases, the attempt to regulate prices by the State has broken down. But so long as the use of money is the main agent in the distribution of most forms of wealth, there may be serious want in the lower strata, and not even discomfort in the richer classes.

At this point account must be taken of the fact that the greater part of the incomes of the people are earnings in return for varied economic services; services of labour of all kinds and of capital of all kinds. But the dislocation of war, in which millions of the best manhood of the nation are engaged, means also a corresponding dislocation of incomes. In all occupations not directly concerned with the war there is a rapid increase in unemployment and a corresponding decrease in income. Here again we see the importance of the check to the foreign trade of Germany both as regards the import of new materials and the export of products. Apart from this there is the natural contraction in expenditure on all kinds of luxuries, but on the making and sale of these luxuries the incomes of vast numbers of the people depend. Whilst in many cases there is a falling off in incomes, in some of the industries stimulated by the war there may be overtime and overpay. In the crippled industries, on the other hand, unscrupulous employers may take advantage of the labour market to reduce the rate of wages. The general conclusion is that in a system of money exchanges the inequalities in the distribution of wealth, which even in times of peace cause social unrest, are very greatly aggravated in a war, with nations in arms.

But the evils of the money method of distribution become much worse if by the financial action of the State there is a general rise in prices. Many people profess not to understand what is meant by a general rise in prices, and still less

to understand the causes. But every one knows in his own particular expenditure of income if it goes as far as it used—if it does not, then so far he suffers from a rise in prices; and if all other people on the average are in the same case, the rise may be said to be general. If the Government in time of war issues a great mass of paper money which is legal tender, and cannot be exchanged for gold, then there is no limit to the rise in general prices that may occur except in the limitation of the issues by the State. In proportion to the rise in prices the paper money is said to be depreciated. In the extreme case the depreciation is glaringly obvious, and everybody understands it in practice only too well. But the beginnings of depreciation are generally overlooked. People think that a rise of prices in war is part of the nature of things, instead of being due largely to emergency finance. Passing over the general difficulties it may be said that the measures adopted by Germany on the outbreak of war are certain to raise prices. The masses of inconvertible notes issued only need time to produce that well-known effect.

In addition to this difficulty there is the further difficulty that arises from the system of banking that in Germany has been carried to an extreme. Everybody knows that the German bankers pride themselves on the assistance given to trade. Even now in this country we hear complaints that similar assistance is not given by our banks to all sorts of trade. This German plan may work well enough when trade is expanding, but even in peace it proves to a be dangerous system in the reverse case of contraction and depression. The difference between the German and the British banking systems is shown by the rates at which the two Governments have been able to issue their loans, the German rate being very much higher than the British. Not only is this the case, but the German loan, being received in depreciated paper, adds so much to the real cost. Taking everything into account, it seems likely that the money borrowed by Germany during the first six months of the war will require double the rate of interest paid by the British Government. This high rate of interest in Germany means so far a relative

breakdown in public and banking credit. As the war progresses the higher command of the money power will begin to be alarmed, and the lower commands of the money power will begin to feel the pressure of diminished resources.

By following out the consequences of the natural shortage of food supplies, etc., and the artificial excess of paper money, we see that with the advancement of winter the economic pressure will be felt more and more severely. The question then arises—Is the ultimate aim and object of the war such as to induce the people to submit to its prolongation? Are the Germans devoted to their Kaiser as the old Highlanders to their chiefs or the Russians to their Tsar? Does the idea of a greater Germany, that shall displace a greater Britain, appeal to the German masses? If Germany is confined within her own borders in the winter, what will be the prospect of the dream of Empire in the spring? These and a mass of similar questions are sure to be asked by all the little Peterkins of Germany, and the Kaiser will be hard put to it, in the face of his former boastings, to explain what good will come of it at last. Taking one consideration with another, the end of the war ought to be in sight with the advent of spring, and, at any rate, the prolongation over a second winter is extremely improbable.

CHAPTER VIII

THE INCREASE IN THE CIRCULATION OF MONEY IN WAR-TIME

(*November* 7, 1914)

THE proper definition of "money" has long been a matter of controversy, and very few people would be able to answer off-hand Sir Robert Peel's famous question—What is a pound? or the other question of the text-books—Are bank-notes money? But in all these controversies, as well as in actual practice, it came to be acknowledged that a distinction must always be drawn between standard metallic money (in this country the gold sovereign) and the other forms of "representative" money that in actual business take its place. The most important in volume of these forms of "representative" money is the cheque, or in the words of the latest authority—"Money in England, as we have long ago recognised, chiefly means a credit with a bank carrying the right to draw a cheque."

But in quality, as distinct from volume, the bank-note is still the most important form of "representative" money. The reason is that it may be made legal tender, though the privilege of legal tender is not accorded to all bank-notes. Before the outbreak of the war the Bank of England notes were legal tender except at the Bank itself and its branches "so long as the Bank continues to pay on demand its notes in legal coin" (3 & 4 Will. IV., c. 98, s. 6). But they were not legal tender in Scotland or Ireland, nor were the notes of the English country banks or of the Scottish or Irish banks legal tender anywhere. Of course, a tender of payment in money other than legal tender (*e.g.*, bank-notes, cheques, silver above 40*s.*), if not objected to, would fulfil

the monetary obligation, and in practice the great mass of monetary transactions are effected, not by means of legal tender, but by the different forms of credit.

It is obvious from the nature of the bank-note itself and the form it bears that it is not strictly money, but a promise to pay money on demand. If a bank-note ceases to be either in law or in fact a promise to pay on demand it becomes inconvertible (legally or actually). The difference between convertible and inconvertible notes is one of the most vital importance, as has been shown over and over again in the history of almost every country in the world. One of the greatest evils that can befall a country is the depreciation of inconvertible paper, and the greater and the more fluctuating the depreciation the greater the evil. The worst of it is that depreciation only begins very gradually, and at first it is not generally recognised. Once, however, the evil has begun and is recognised, it is only to be remedied by the simple but drastic measure of cancelling a sufficient mass of notes, which means a corresponding loss to the Government, for people will only give up even depreciated paper for its value in some other form.

The mere declaration that notes are to be made inconvertible (or that the obligation to pay gold is no longer binding on the bank of issue) is not in itself enough to cause depreciation. In spite of such a declaration the notes may for a time be accepted at their full face value. But when the volume has been swelled beyond a certain point depreciation is certain to set in, and there will be a difference between prices measured in gold and measured in paper. Anyone who has been in a country with inconvertible paper that is depreciated knows that he can obtain more than the nominal amount of paper money for a certain amount of gold.

The beginnings of inconvertibility may be sudden and publicly declared, as on the outbreak of the present war, in both Germany and France, where the notes were at once made inconvertible. But in other cases the beginnings may be gradual and insidious, and there may be *de facto* incon-

vertibility before legal inconvertibility is declared or even generally recognised. In this country, on the outbreak of war the Government did not think it necessary to make the notes of the Bank of England inconvertible, and the Bank was obliged to meet its notes with gold on demand, and for a time there was actually a run on the Bank for this purpose. It was stated, however, in the *Economist* at the time that even at the outset the Government were advised by some people of financial importance to make the notes inconvertible. As the event showed, such a procedure would have been quite unjustified, and the note of the Bank of England remained what it professed to be—a promise to pay gold on demand.

But although the Government did not adopt the method of inconvertibility, it took several steps in the direction of lessening the actual power of convertibility. It did not say bankers need no longer pay their notes in gold on demand, but it put difficulties in the way of the demand being made. It extended the privilege of legal tender, for example, to the notes of the Scottish banks, and the notes could only be presented for gold at the head offices of the banks. But the longest step towards *de facto* inconvertibility was taken by the issue of Treasury notes for £1 and 10*s*. These notes were declared to be legal tender, and they could only be presented for gold at the Bank of England in London. As these notes are legal tender, it is obvious that there is no inducement for people to present them for gold unless they become of less value than the gold; they cannot take the trouble to send the notes to London and get the gold, and the banks all over the country are not likely to assist them in what they would call hoarding. Even before the new Treasury notes were issued the Chancellor of the Exchequer implored people not to ask their bankers for gold. He assured them the Government was printing sovereign and half-sovereign notes as fast as possible. Once these notes were ready, it seemed to be a public duty to use them in preference to gold. Some patriots wrote to the papers stating that they had sent in all the gold they

could to the banks, and for a time to ask for gold was considered as sinful, as in former times to ask for usury on lending gold. But, apart from this appeal to the public conscience, the banks were encouraged or commanded not to pay out gold, even if unconscionable people asked for it.

At the same time the Government declared a moratorium by which people were allowed to postpone the payments of debts incurred before the war, and this privilege was to a great extent taken advantage of by the banks. Even money on deposit or current account could not be legally demanded by the creditors, and any advances to them out of their own money was at the discretion of the bankers. The curious thing was that at the same time people were admonished to use cheques as much as possible for all kinds of payments, which, of course, meant that, as in the United States in the panic of 1907, cheques became a kind of inconvertible currency. The use of "representative" money was further extended by making postal orders legal tender even for small amounts. The amount of silver money was increased, and silver is "representative" money inasmuch as the metallic value of a shilling is less than fivepence.

Attention has been called recently by the Treasurer of the Bank of Scotland to the increase of "money" in circulation in Scotland. The increase is said to be some two millions sterling, and it is observed that, "considering the population, this is a very large increase." But at the same time it may be pointed out that, considering the population, the increase in Scotland must be less than in the rest of the United Kingdom. The population of Scotland is, roughly some 10 per cent. of the population of the United Kingdom. The new Treasury notes outstanding by the last return amount to over thirty-one millions sterling, and if Scotland had its proportionate share of this increase it would amount to over three millions. But the Treasury notes are only one form of "representative" money. In Scotland their place has been taken to a great extent by the notes of the Scottish banks, which, of course, means so much more of the Treasury notes for the rest of the Kingdom.

This great increase in legal tenders with imperfect convertibility, unless checked and remedied, can only have in time the usual consequences—namely, a rise in prices, and eventually inconvertibility and depreciation that must be acknowledged. On the outbreak of the war there was no doubt room for a considerable increase in legal tenders, simply because there was so great a destruction of ordinary bankers' credit. In the same way, for the time being, it was natural for the Bank of England to be anxious about an adequate reserve of gold. But once the first shock of the declaration of war had passed there was no need as regards the internal circulation for flooding the country with "representative" money. In spite of the extraordinary application of the moratorium to banking accounts, the banking system of the country has contrived to settle down to ordinary business. The latest Clearing House returns show only 10 per cent. diminution as compared with the corresponding week of last year. The rates for money in the London money market are, considering the war, surprisingly low. And yet every week the issue of Treasury notes is increased, and the increase last week is greater than ever.

It is true that for some time an increasing amount of gold has been set aside, supposed to be ear-marked for the redemption of these notes; but, as already explained, the notes are not likely to be presented for conversion until depreciation is actually observed, which especially for notes of low denomination, such as 10s., is always a matter of time.

The people of this country had become so accustomed to the smooth working of the currency, and the effective maintenance of the gold standard, that they were prepared to accept loyally any emergency measures that might be recommended without much scrutiny. They even accepted the position that though a bank-note was simply a promise to pay gold on demand, it would be bad form to ask for the payment. But if greater evils are to be avoided it is time that the increase in the currency should be stopped and

the *de facto* convertibility renewed. If masses of legal tenders are thrown into circulation with no efficient means for withdrawal, in the course of time prices will rise and more currency will be needed to effect exchanges on this higher level. The more money is issued the more will be demanded. The simple and effective way to prevent an increase in the circulation is to put the issues on the old basis, or on some other definite basis of limitation. The new Treasury notes are in direct contravention of the system that has governed the issues of notes in this country since 1844 (and 1845 for Scotland). The old principles have been abandoned, and so far as the public is concerned no one knows by what principles, if any, the new issues are governed. If the ultimate object is that in England the Treasury notes should take the place of gold under the idea that the gold displaced would flow into the Bank of England, the methods adopted do not seem to be successful to any extent.

CHAPTER IX

PROBABLE EFFECTS OF THE WAR ON RATE OF INTEREST

(*November* 20, 1914)

As the result of the war there will probably be a considerable rise in the rate of interest. The consequential effects on the values of securities of all kinds are of the highest practical importance.

In general, as is shown by reference to history, and especially to the history of the last twenty years, it is very difficult to forecast the movements in the rate of interest. Twenty years ago no one foresaw the great rise that was to take place, with the consequential fall in the price of Consols and other first-class securities. It is easy to give the general reason why it is so difficult to forecast movements in the rate of interest. The rate of interest depends on the demand and supply of loanable capital, and both the demand and the supply depend on a number of different factors, varying in force and in direction. The calculation of the resultant effect of all these influences is rendered more difficult in recent years by the increasing extension in the field for investment and in the demands for capital all the world over.

Since the difficulty of forecasting is in general so great, it may seem pure guesswork to try to foretell at this stage the probable effect of the war on the rate of interest. Yet the general argument in favour of a probable rise seems quite convincing, and may be put in two propositions.

The first is that as the result of the various causes affecting the demand and supply of loanable capital there has been a rise during the past ten years in the yield to first-class securities with fixed interest—*e.g.*, Consols and railway debentures. Before the outbreak of the present war there

was no sign of any reaction, though new issues were waiting for a favourable change. We must suppose, then, that the causes of the rise in the rate were still operative this summer, and that the general resultant was the same in spite of changes in the particular elements of demand and supply.

The second proposition is that in consequence of the war the demand for capital will greatly increase, whilst the supply in general will be greatly diminished. An examination of some of the principal causes affecting the demand and the supply will make this statement quite reasonable.

Take first demand. Demand for loanable capital is broadly of two kinds—namely, for productive and for unproductive consumption. The greatest of unproductive demands is for war. The chief cause of the growth of national debts in the past has been war. The present war will accumulate debt more rapidly and to a greater extent than any previous war.

The next great unproductive demand is on the part of Governments for social reforms of all kinds. The war, instead of diverting this kind of expenditure to military requirements, tends to increase it. Let any one consider the proposals made for the soldiers and their dependants on the return of peace. If any considerable part of these proposals are carried into effect, the country will be burdened with many millions of extra expense. If this expense is met out of revenue, less of the actual military expenditure can be so met. Indirectly, if not directly, the demand for social benefits must increase the indebtedness of the country. The growth of debt will be facilitated by the increased laxity in public opinion as regards debt and economy. Before the war the increase in social expenditure involving fixed (or increasing) charges had been advancing without any serious protest from any responsible statesman. After a successful war and the salvation of Europe from German militarism, no reward will seem too great for any who took part. Other generations must be expected to bear some of the burden, just as we are still bearing the burden of crushing the great

Napoleon a century ago. Judging by recent modes of measuring national achievement, the greater the debt that is piled up so much greater will be the glory. What is true of this country is true of all the countries in the world. We have no monopoly of social reform. In many expensive reforms we have not even taken the lead; we have tried to make up for lost time regardless of expense. There can be no doubt that on the side of the demand for capital there will be a great increase on the part of the greatest of unproductive consumers—namely, the Governments of the world.

The demand for productive purposes is also likely to be greater than before the outbreak of the war. The experience of the Franco-German War in the 'seventies is instructive. The conclusion of peace was followed by a great outburst of industrial activity. All the destruction and all the deferred expenditure caused by the war had to be made good. But the war in question was in the magnitude of the strain not to be compared with this war. If the world on the conclusion of the war is to try to resume its former productive activities there must be a great demand for capital.

The case seems equally clear if we look to supply. War involves a great actual destruction of old capital (witness Belgium) and an almost complete check to accumulation of new capital in the countries directly affected. Indirectly other countries feel the depression in trade and industry. Even in the United States a check must be placed on accumulation of capital during the war. It is true that certain kinds of industry are stimulated by the war expenditure—those providing, for example, war materials and soldiers' necessaries, such as boots and uniforms. This country, in particular, is suffering much less as regards employment than might have been expected. But after all allowances are made, it is not probable that there will be any real surplus of new capital created during the war. On balance the consumption will probably exceed the savings.

The general conclusion that the war will increase the demand and lessen the supply of loanable capital is strengthened rather than weakened when we look into the

more particular influences. In spite of the large increase in debt there will also no doubt be a great increase in taxation. We cannot transfer all the burden to future generations. Recent experience tends to show that the increase in taxation will be made to press most heavily on the classes which, whatever their other defects may be, are the chief providers of new capital. But in any case the heavier the taxation so much less is the power of accumulation.

On the side of demand one of the chief causes of the recent rise in the rate of interest has certainly been the growth of security all the world over. New and undeveloped countries have been trusted to a greater extent than ever before. The area of the demand for the loanable capital of old countries has enormously increased. The conclusion of the present war in which half the world is engaged seems likely to be followed by a period of forced repose. The break-up of the military power of Germany will in the end strengthen the general security of the world at large, and thereby increase the demand for capital.

There is, however, one apparent exception to this general array of forces leading to a probable rise in the rate of interest after the war—an exception that is of special importance at the present time. A reference to the money articles in the papers seems to show that after the first week or so of the war there has been in the London money market an apparent glut of money. After three months of war the market rates for money for short loans are remarkably easy. The Treasury has been able to float loans for six or even twelve months at about $3\frac{1}{2}$ per cent. It is true that the Bank of England rate has been 5 per cent. for the last three months, but this high rate as compared with the market rate is due to the exceptional character of the Governmental demands on the Bank for its various guarantees. And after all, the rate of the Bank of England in spite of the penal character of some of its charges on behalf of the State is no higher than it was a year ago in the midst of profound peace.

It may then, perhaps, be thought that if the Bank and the Government have got over the first disturbances of credit so easily, in the course of time their difficulties will become less and that the rate of interest in the London money market may fall even lower as the war progresses towards its inevitable conclusion.

It must be remembered, however, that the present apparent ease in the London money market is largely due to the artificial creation of legal tenders and bank credits by the action of the Government. It is hardly likely that this easy method of increasing the supply of money can continue "for three years or until the end of the war," whichever happens to be the more distant.

But the point is that the rate of interest on the investment of capital for long periods depends on more wide reaching and more fundamental causes than the abundance or the reverse of legal tenders and Governmental guarantees in London. London is the great Clearing House of the world, but London only creates a small part of the capital in which it deals. The demand and the supply of the loanable capital depend on real causes beyond the power of Governmental control. A recent estimate by Sir George Paish put the interest on British capital invested abroad at about two hundred million sterling, and the corresponding capital would perhaps be some three thousand millions. This again is only a small part of the world's capital, and more and more the rates of interest on capital all the world over tend to be influenced by the same causes. The present war will probably raise the rate of interest not only in the belligerent countries but in all countries. The influence of the London money market on the final result will be very small.

There is, indeed, one way in which the manipulation of credit in London and the other great financial centres may affect the rate of interest, and that is by raising prices of commodities to a greater height than otherwise would be the case. The partial abandonment of the gold standard, and the various checks imposed on convertibility into gold,

have the same general effect as an increase of inconvertible paper. In the process of the inflation of credit (that is relatively to the contraction which would naturally take place in time of war) prices rise. If at the conclusion of the war the same outcry is persisted in for Governmental monetary assistance, and the actual use of gold is still further restricted, the rise of prices will continue. But the general effect of such an artificial abundance of money and a consequent rise of prices is to stimulate industry for the time and intensify the demand for capital; just as in recent years the continuous rise in prices has partly caused the rise in the rate of interest. The only influence in favour of a fall in the rate of interest after the war is the possibility of a far-reaching financial crisis forcing a real return to the gold basis, with a consequent fall in prices and a check on speculation of all kinds.

In the meantime, however, these rather obscure influences of gold on prices may be left out of account, and the general conclusion seems to be that after the war the rate of interest will be higher for corresponding securities than before the war. This, of course, means a corresponding fall in the capital value of securities with fixed interest, and indirectly all other securities will be so far also affected. The consequences of such a readjustment of the values of investments are of the highest importance, not only to all classes of investors, but to the various Governmental borrowers of the world.

CHAPTER X

THE FIRST WAR BUDGET—AND AFTER

(*December* 12, 1914)

THE Budget has been received with a chorus of resignation. Practically no discussion has taken place either in Parliament or in the Press. Any suggestion of any slight modification has been couched in terms of apology. The reticence enforced in matters of war has been self-imposed in matters of finance. This benevolent silence is extended even to the past—the very near past. The reason is simple. Everybody wishes to support to the best of his ability the credit of the nation, meaning in this connection the financial credit. Everybody knows that the war is costing a million a day, and everybody thinks that the money power of the nation rests on the national credit, and that in time of war the national credit rests on the credit of the Government. It has been often pointed out in these papers that the credit of the nation must rest on real foundations, and that national financial credit is a very different thing from mere confidence. The constant references to the credit of this country being so superior to that of others are generally associated with new demands for Governmental expenditure, or, at least, Governmental guarantees. If the real foundations of the national credit are alluded to at all, it is generally in the form of vague estimates of the national wealth. We are told that this country has wealth to the extent of some eighteen thousand millions. What is three hundred and fifty millions of debt in the face of such assets? It is forgotten that the greater part of this national wealth consists of lands, houses, railways, and all kinds of fixed and specialised capital that cannot possibly be converted

into war materials or necessaries for the dependants of soldiers, or even into the gold that is supposed to be the foundation of our banking system. The Chancellor of the Exchequer in his last speech said that if the banks had attempted to realise some fifty millions of Stock Exchange securities--presumably as they were the basis of bankers' loans, they were, if not first-class, at any rate good second-class stocks—they would have knocked the bottom out of the market, and apparently precipitated the long-deferred financial crisis. But if such holdings cannot be realised to the extent of less than a paltry fifty millions, what is the use of talking of the national assets being worth eighteen thousand millions?

As a matter of fact, national income is a much better test of national financial strength than the supposed corresponding capital, the value of which varies with every change in the rate of interest and with the number of years taken as the basis of the conversion of income into capital.

In the final report to the first Census of Production, Mr. A. W. Flux estimated the aggregate income of the United Kingdom as about two thousand millions. Of this amount less than three hundred and fifty millions is set aside to be added to savings and investments. The remainder consists of the values calculated for the goods and services consumed by the people engaged in providing the various goods and services.

A good deal of this income must be used in keeping up the "living capital" in the form of human brains and muscles. A large amount is already assigned to various forms of expenditure, and cannot be diverted without serious unemployment. Already in times of peace large slices are taken in national and local taxation. When all the necessary deductions have been made and all the prior claims satisfied, the amount of taxable income available for the demands of war becomes a very modest figure compared with the "stupendous" figures of national wealth.

It may, of course, be said that the Government has the first claim, but even a Government must take care not to

trench on the sources of the taxable income or injure the productive power of the nation. Taxation beyond a certain point is suicidal. And if taxation in the present is avoided by resorting to debt, debt is only deferred taxation. The present increase in the national debt by the War Loan means over twelve millions extra taxation simply to pay the interest, and the next instalment of debt is likely to be at a higher rate.

There can be no doubt that the people of this country will have to face a great increase of taxation, both present and deferred, and the present Budget is only a beginning. In a national emergency nobody expects any nice attention to the details of the methods adopted. Adam Smith learned from the wisdom and the unwisdom of his predecessors in theory and practice four great rules or canons of taxation, and his successors also, warned by experience, have added a good many more, not by any means mere counsels of perfection, but good, honest working maxims. The text-book writers also point out that in the case of any conflict the less important rule must give way to the more important, just the same maxim that the great Clausewitz gave as the first maxim of war.

In the present great emergency there is no doubt that the other rules of taxation must give place to the fundamental rule of productiveness, and the productiveness must be immediate. Simple as it seems, this rule cuts away a number of proposals. Taxes are often imposed, not simply or mainly for present revenue, but for various political or social objects. Taxes on alcohol are supposed to be partly, at least, preventive or penal. The method of enforcing sobriety by taxation may or may not be effectual (Adam Smith thought it was not), but unless we are prepared to follow the example of Russia the increased tax on beer ought to be regarded simply as a means of raising revenue. In the same way, all the taxes that are constantly proposed for improving the morals or manners or health of the people must at this time be considered from their revenue-producing power.

If it is admitted that the object of war taxation ought to be revenue, then that mode of taxation is best which gets most cheaply at the revenues of the people. There is a principle of taxation which has important consequences to the effect that all taxes fall on persons and not on things. We talk of taxing tea—what we mean is taking part of the incomes of people who drink tea. On a strict analysis, all taxes are disguised income taxes. Local rates on property are a very rough method of getting at the incomes of people. Adam Smith, the greatest of masters of finance, classified all taxes according to the incomes on which they fell—*e.g.*, rents, wages, profits—and he put taxes on commodities in line with them by saying that they fell indifferently on all species of revenue. All the intricate machinery of indirect taxation is only intended to get at the real incomes of people so far as the taxes are revenue-producing. In principle a universal income tax which took directly the due share of the State from the revenue of everyone would be the best system of taxation. The first great rule of taxation laid down by Adam Smith is that the subjects ought to contribute in proportion to the revenues which they enjoy under the protection of the State. And the simplest method of all would be to make everyone pay his share directly.

Unfortunately, however, as the history of the British income tax shows, any attempt to put this apparently simple rule into practice bristles with difficulties. What is the meaning of income for taxable purposes? How are the true incomes of the trader, the manufacturer, the professional man, the farmer, to be ascertained, and so on of all the occupied classes? If we rely on self-assessment, most people think the first rule of taxation is, if possible, to evade it. Gladstone and John Stuart Mill were horrified at the immorality of the old income tax. Gladstone always professed to hope for its entire abolition. Are all incomes of the same size to be taxed at the same rate independently of their source?—perpetual and terminable incomes, incomes from land, and incomes from medical practice—or, more generally, are the "industrious" incomes to be taxed at

a lower rate than the "lazy" incomes, to recall Gladstone's names for earned and unearned? It is to be observed that Gladstone always looked in the first place to the great productive power of the income tax. He would not have it nibbled at here and there on all sorts of grounds lest its efficiency as a revenue-producer should be destroyed. Not that he forgot the equity of the case, but even that side he looked at first from the point of view of the productivity. If you want to get a certain amount of revenue (*e.g.*, for a Crimean war), then every exemption you grant means so much more taxation on the people not exempted. As for the nicer adaptations of practice to theory in the collection of income taxes, he thought (in 1860) that they must be left to the little legislators who were then in the nursery. The little legislators have grown up, and the income tax has grown with them. The exemptions also have grown, with the consequent rise in the burden on the incomes not exempted.

The doubling of the income tax in the present Budget can only be approved of as an emergency measure, which is to be followed by a corresponding increase in the taxation of the classes who at present come within the range of exemption. Even on the bare principle of productiveness it is hopeless to raise a war revenue solely at the expense of the richer classes. Who are the richer classes? In his speech on the War Loan the Chancellor of the Exchequer rejoiced that the small investor had come forward—there were actually one hundred thousand applications. There must be nine millions of families in the United Kingdom. It is plain that the hundred thousand patriots cannot bear all the burden of the war. In the next loan more patriots will have to be attracted by a higher rate of interest and a lower limit of subscription. But debt in any form is only deferred taxation. The small minority of subscribers to the loan will receive interest, but the vast majority of taxpayers must pay it. There is no escape from the position that the revenues of the State even in peace cannot be raised only from the idle rich.

Even in times of war some regard must be paid to equity. The first duty of any civilised Government is to secure justice. The simple doubling of the present income tax has also more than doubled its inequalities. The rise in the taxes on tea and on beer has also increased the inequalities of indirect taxation. The productivity has also been lessened by the failure to tax possible substitutes. The drinker of beer may be encouraged to take to spirits, and incidentally destroy the supposed moral value of the new tax.

In the next War Budget, both on the grounds of productiveness and of equity, the basis of taxation must be widened. It is probable that the difficulties (non-political) of direct taxation on lower incomes have been exaggerated. In the Napoleonic wars the limit of exemption of income tax was lowered to £50, and abatements were only allowed on incomes up to £150. This, too, was a period when the range of prices was much higher, and everything and every occasion was taxed. In Gladstone's great Budgets in time of peace the limit of exemption was £100. Local rates are now levied so as to fall on much lower incomes—so are insurance taxes. But if it is feared that direct taxation cannot be extended, then the only alternative is to broaden the basis of taxation on commodities. Only in that way will the great mass of consumers be made to contribute. This widening of taxation will have the advantage of bringing home to the masses of the people the burdens of war.

It is of at least equal importance, in view of the enormous expense of the present war, that more regard should be paid to economy in every department of the State. Of recent years, in times of peace, economy in the public expenditure has apparently become a matter of no concern to so wealthy a nation and its stewards. "It is a characteristic of the mischiefs that arise from financial prodigality that they creep on with a noiseless and a stealthy step." So said Gladstone in 1861. But the wisdom of economy is as old as taxation, and generally as much disliked.

CHAPTER XI

THE MEANING OF ECONOMIC PRESSURE

(*January* 2, 1915)

In an earlier paper (see Part II., Chap. VII., p. 208) reasons were given for the opinion that the war was not likely to be of long duration, founded on the influence of economic pressure on Germany. The argument advanced was threefold. First, regard was paid to economic pressure in the simplest sense of the term—namely, as involving a real shortage of necessaries of the first order and of necessaries of the second order, or so-called conventional necessaries. In the last few days signs have become of increasing frequency and importance that already this simple elementary economic pressure has begun to be felt in Germany. For a long time all the reports that reached this country of conditions of life in Germany were to the effect that "life as usual" was going on just as if there were no war. Restaurants and cafés were open, and there were no shortenings of the menus or enlargements of prices. It was stated, officially and unofficially, that Germany had enough supplies for a year, with the further implication that a country so self-contained and economically independent would be able to replace the year's supply by another in the ordinary course of the seasons. On the face of it, this optimism seemed as ill-founded as the military optimism when the dependence of Germany on foreign sources of supply—*e.g.*, in wheat, fodder for animals, etc.—was taken account of. The natural conclusion seemed to be that if Germany was consuming as much victuals and drink as usual at the usual prices, the elementary economic pressure would begin to be felt in the middle instead of at the end of the winter.

The belated warning of the economic Professors in Berlin, which has not been disavowed, and was perhaps suggested, by the Government, is significant. The Professors are obliged to fall back on the very rudimentary counsels of prudence and thrift which used to be the commonplaces of the old political economy. "Waste not, want not," has been expanded in the Germanic manner into five good-sized paragraphs, with illustrations. Not "life as usual," but the simple life is to be followed—so simple that the only bread is to be "war" bread, and more refuse than usual is to be put into the sausages.

More significant still is the intimation in the *Times* of December 23 that "about ten days ago the German Government's own organ, the *North German Gazette*, and the chief military journal in Berlin, the *Kreuz Zeitung*, were confiscated. Their crime was that they had published certain resolutions on economic subjects by the Chamber of Agriculture of the Province of Brandenburg." One of the offending resolutions urged the Government to organise immediately a scheme of sale and purchase by the Empire at fixed prices of the corn necessary for the German Customs Union. This measure, it was said, must be taken "before it is too late, and in order to avert dangerous evils as regards the supplying the German people with bread." Another resolution called attention to the growing scarcity of saltpetre, which villainous substance is as necessary for the manure of agriculture as for the munitions of war. Attention has already been called to the shortage of copper and other things of the nature of necessaries in war.

But shortage of the necessaries of life or of war is not the only kind of economic pressure, nor is it always the most effective. There are more ways of dying both for nations and individuals than by starvation, and starvation is a matter of degree. Semi-starvation is in many cases good for body and soul—the fasts of most religions have a foundation in reason. Granted that Germany has been accustomed of late years to import of one kind or other one-third of her food and drink supplies, it is quite possible that on the average, if

the adult German reduced his consumption by one-third he would be none the worse—even English people have been seriously recommended by the doctors to eat and drink half of their usual allowance. And even in the necessaries of war a shortage of supplies may be beneficial, since the economy of material may lead to an economy of men, as seems to be evidenced by the recent change in German tactics in the West.

But there is a second kind of economic pressure that may be even more effective than shortage of necessaries. Before the necessaries are consumed they must be distributed amongst the people. And the means of distribution may break down under the new economic pressure of war.

Suppose that on Christmas Eve a statistician were to prove that in England there was abundance of meat and of materials for plum puddings to provide a full Christmas dinner for everyone in the kingdom, most people would feel no surprise. They look on their country as a land overflowing with meat and pudding. But if the same calculator were to say that therefore everyone on Christmas day would have a good dinner, this conclusion would seem as obviously false as the other was obviously true. The people would get the dinners if they had the money, or if someone else with the money paid for the dinners. But no money, no dinner. Even Government officials must get their dinners out of taxes, and the paupers out of poor-rates, and those who have no money and cannot dig and are ashamed to beg must remain unfed.

These commonplaces may be put in a more scientific form by saying that in the modern State the mechanism of distribution is a complicated system of exchange that is worked entirely by money and the credit-substitutes that take the place of money. This mechanism is extremely intricate, and may be put out of gear and rendered partially unworkable by what seem to be very small causes. The failure of some great financial house (*e.g.*, in 1866) has been sufficient to cause or occasion a severe and prolonged commercial crisis. The crisis of 1907 induced by the bad

banking of the United States had world-wide effects. When the present war broke out the first concern of the British Government was the state of money and of credit. The Navy might keep the seas, but the food supplies would not come in unless they could be paid for, and if they were to be paid for the mechanism of exchange must be repaired in some way or other. Everyone knew by experience or report the evil effects of a breakdown of credit in a commercial crisis, and everyone expected the war to be as dislocating as ten commercial crises in one. These facts are only alluded to in order to show the fundamental importance of the money economy in the industrial life of the nation. When people say that money is only a medium of exchange—only a means of avoiding the inconveniences of barter—they only express a half truth; the other half is that in the modern industrial State money is practically the only medium of exchange.

In simpler forms of society, in mediæval times for example, a great part of the wealth of the country was distributed without the intervention of money—the various village communities and manors were more or less self-sufficing, and the shares of each member were determined by conditions of status. But the economic progress of society has been coincident with the substitution more and more of a money economy for what used to be called a "natural" economy. A few years ago the extreme advocates of State Socialism proposed in effect a reversion to a kind of "natural" economy. They proposed that the State—a kind of god out of a machine—should distribute all the wealth made by the society according to the dictates of natural or acquired justice. The Socialist State was to be a State without money. Money was the root of all evil. The money power was the greatest curse from which the world had ever suffered, *und so weiter*. But as soon as the difficulties in carrying on the distribution of wealth without money were pointed out, they were seen to be so formidable that the moneyless ideal was abandoned.

It is hardly likely that the German Government, in the

midst of a war for existence, can think of undertaking the complete distribution of supplies in the same way as rations might be distributed in a besieged fortress, in which no account would be taken of the money each one might happen to possess.

And yet already in Germany it is proposed that the State should take over all the supplies of food, and regulate the distribution. Such a resolution of the Chamber of Commerce of Stuttgart was reported in the *Times* of the 23rd ult.

Even if the central authority were to take command of the food supplies for the whole of Germany in the way suggested, it is doubtful if the distribution would or could be effected without the intervention of money. The State might fix maximum prices, and might ordain that no one should buy more than a certain amount. But in times of scarcity it is not only the state of prices but the means of purchase that must be considered. How are the ordinary or usual incomes of people to be secured if through the want of raw materials manufactures are lessened, and if the providers of all kinds of secondary luxuries find no demand for their services? A large part of the able-bodied men are actively engaged in the war, and another large part in the industries and communications subsidiary to the war. They cannot at the same time produce the usual flow of consumable wealth. If the German soldiers are paid at all, they are certainly paid far less than our so-called "mercenaries," and their families must be much less well provided with money.

It might be thought that if there was not enough money, all that the Government need do is to print more money. A writer in the current number of the *Round Table* asserts that Germany can always print off plenty of money. Nothing, indeed, is easier than to print bank-notes if you have the paper and the machinery. But people cannot eat bank-notes—they cannot even eat token silver coins or postal orders. To him who has most money most of the real things he is in need of will be given, unless the State doles out the rations and sees that the rations are consumed on the official premises. Otherwise the recipients may sell their shares,

and deprive their own families and themselves of food in order to get other things, for it is well known that if people are left to themselves they prefer the conventional secondary necessaries to the real healthy means of subsistence.

If we follow out this reasoning, it is easy to see that an apparent sufficiency of supplies per head may in effect be associated with semi-starvation at one end of the social scale and repletion at the other. Besides, people do not live by bread alone, and to those who have been accustomed to a fair standard of comfort the enforced privations of ordinary luxuries will be a constant reminder of the hardships of war.

The money side of economic pressure must be considered, not only in the relatively simple cases of the money incomes of individuals, but as affecting the resources of businesses of all kinds. More and more joint-stock enterprise has displaced the private firm. As a rule, such companies borrow to the full extent of their credit. Before the war there were evident signs in Germany of over-trading and over-expansion of credit. The liquidation may be postponed, but when it comes it must be all the more severe on account of the war.

The German Government, with all its power, cannot get on without money; and it cannot get on simply by printing money. It must impose taxes; it must issue loans. Every tax that is imposed or increased makes the next levy more difficult; every new loan that is issued is more difficult to place. With the present enormous expenditure the pressure of new taxes and of new loans must be very severe in a short time. But this means that the great financial houses will be put in danger and they may be trusted to show the dangers of the collapse of the credit system of the country.

When the economic pressure has begun to be felt in the failure of consuming power and of money power, then these two kinds of pressure will be increased by the third kind, which is the psychological. People often write of economic matters as if political economy had nothing to do with feelings or mental things, but only with bodies and material things. But in truth political economy deals with men mainly from the psychological side. Wants and their

satisfaction are the farrago of our little text-books. Take it in the concrete, some of the greatest strikes on record have been undertaken and continued in the face of certain monetary loss, simply for some kind of sentiment. Nations will endure great privations to secure something on which they have set their hearts, and to the reader of history nothing is more saddening than the everlasting succession of great wars waged for purposes that to the next generation may seem unreasonable. Can we suppose that the object of the present war, as presented to the German people by their own prophets, is such as to induce them to fight to the bitter end? When the dream of the world-empire has vanished in the mist, what is there left to fight for?

It may, perhaps, be thought that the general arguments here advanced apply also to the Allies. That is true, but to a much less extent. Russia, by its magnitude and by its relatively primitive economy, cannot be wounded in the same way as a modern industrial State such as Germany. France and the British Empire have the command of the sea, and the command also of foreign credit. Even in these countries the economic pressure will be severe; even in Britain there is need for far more elementary economy and far less extravagance than is being practised alike in low places and in high. But we have a larger margin to draw on than Germany; and we have a cause that so appeals to our first instincts of liberty that, whatever may happen, the third kind of pressure, the psychological, will only harden our hearts.

CHAPTER XII

THE ECONOMIC PROSPERITY OF WAR-TIME

(*January* 9, 1915)

THE reviews of the financial and economic conditions of the principal countries of the world, which have been published as usual at the end of an old year, have revealed some astonishing contrasts. If we compare, for example, the United States of America with the United Kingdom, the result of five months' war is exactly the opposite of what was generally anticipated at the beginning of August. It was supposed that the United States being at peace, whilst all its great competitors were using all their resources in the greatest war on record, the outcome must be a great expansion of American trade and industry and a corresponding economic depression in the belligerent countries. In particular, it was thought that the United Kingdom would suffer severely through the loss of trade, and at once a great stimulus was given to the creation of a large fund for national relief. But the annual reviews of the newspapers have shown that the economic forecast for the two countries has apparently been exactly falsified. It is America that has been afflicted with the east wind that the angler's verse tells us is good for neither man nor beast, whilst the British Isles have had the west wind, which is the very best. Consider the conditions of the masses of the people as shown by the statistics of unemployment and pauperism in the United Kingdom. We are told that in both respects the figures are below the normal. In London there was never a Christmas with so little flagrant destitution—a docker can earn, if he pleases, a pound a day. But in the United States unemployment is above the average, and the

belated Note of the United States Government ascribes the depression of trade to the inquisition of the British Navy. What is true of the United States seems to be true of other neutral countries. Holland, Switzerland, and Italy—even Spain and Portugal—are all complaining bitterly of the effects of the war on their trade and industry.

As regards the British Empire, it seems to be only the parts that are most removed from the seat of war and its direct effects that are suffering. Emigrants are warned that the Britains overseas have no vacancies—they have enough to do to provide for their own sea-maws. Australia, New Zealand, South Africa, and Canada all tell the same tale—no room for emigrants owing to the war and the consequent depression. In the meantime John Bull himself puts under arms a couple of millions of his best workers and supplies them with material comforts such as were never dreamed of before in times of war. If we take the family as the unit, many of the families of the soldiers are better off than in times of peace, and some of the non-combatants are having the time of their lives in the plenteousness of the separation allowances. John Bull was told that with the advent of a European war the London money market would be smashed and its glory be passed on to another. It is said that the Germans (naturalised and other) laid mines for the financial explosion which was to wreck the Bank of England and shatter London's credit. What happened ? Apparently a week's Bank Holiday was enough for John Bull to put his house in order. The crisis was effectually suppressed. The best proof is that, according to the *Times*, all over the United Kingdom there has been a decrease in the volume of insolvency during the war. Any part of the business of the country that seemed unable to run itself was run by the Government. Governmental control was carried to such an extent that the old presumption against Governmental management of business was reversed, and just at the very time when the extraordinary functions of the State were enormously added to by the war, a demand was made that the State should undertake all sorts of things

that were usually managed by private enterprise. Under this new reliance on the State emergency measures have been prolonged and increased in scope and variety. With the new year the Stock Exchange has been made practically into a Governmental department, so stringent are the rules against freedom of contract and any form of speculation.

This extension of Governmental management has been accompanied by a great increase of Governmental "money." Not only have Treasury notes been issued to the extent of over thirty-eight millions as legal tenders for £1 and 10s., but banking credits have been still more increased by all kinds of Governmental guarantees. The consequence is that the end of the year found the London money market in a state of ease that had not been paralleled for over twenty years. London was apparently rolling in money. And, as was often pointed out, this extraordinary abundance of money and this buoyancy of credit had been attained in spite of the issue of an enormous war loan.

Besides this our Allies and the other States of the British Empire have all made calls on British credit and have all received assistance. It was reported that even the United States of America, in the early days of the war—long before the Note on contraband was thought of—was accommodated with a loan of British gold. British credit seemed and still seems like the widow's cruse, with the Chancellor of the Exchequer as prophet.

These exuberant signs of prosperity, especially as compared with other countries that are at peace, admit of explanation, and the explanation suggests some misgiving. "The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate"—so said Adam Smith in another connection, but the comparison is useful in dealing with war finance and its effects. The history of many great landed estates is a history of the ruin of their original possessors by the accumulation of debt. Every new mortgage is accompanied by an abundance of ready money and corresponding extravagance. The particular village or city in which the expendi-

ture is made enjoys for the time exceptional prosperity. The reaction comes when the loan has to be renewed—when the capital has gone and the interest has to be paid.

The present War Loan and the various extensions of Governmental credits are essentially the same as the borrowings of the landowner, and the immediate effect is the same, though the moral motive is different. It is not necessary to press the analogy. The same argument may be put in a more general form. "The moment in which war begins . . . an immediate and great expense must be incurred, which will not wait for the gradual and slow returns of new taxes. In this exigency the Government can have no other resource than borrowing." Adam Smith goes on to explain how in a country abounding in merchants and manufacturers capital passes through their hands rapidly, and can be to a great extent diverted to the needs of the State. He points out also that by lending to the Government they do not even for a moment diminish their ability to carry on their trade and manufactures; on the contrary, they commonly augment it. Certainly in the present war the Government has taken pains that the extension of public debt shall be accompanied with the extension of private credit. The subscribers to the new War Loan can borrow to the full extent at less than the Bank rate—even at 2 per cent. below this official rate. These great sums raised by the State are expended for the most part within the country, and this increase of expenditure is for the time associated with increased consuming power on the part of the people. As it happens, this country also enjoys the immediate effects of the expenditure of other countries which have also been obliged to borrow either for war or for safeguards against war. It is as if the village was enriched not only by the borrowings of its own landlord, but by the incursion into the festival of all his great spendthrift neighbours.

This explanation of our present prosperity is confirmed by an appeal to other examples of mortgaging the future. The inflation that precedes a commercial crisis is marked

by an undue expansion of spending power. The greater the inflation of the credit so much greater is the apparent prosperity. In essence the process is always the same. Wealth that ought to be adapted for the supply of future needs—which is the main function of capital—is converted to present needs. The corn meant for seed is eaten up by the soldiers, the seed corn being typical of all kinds of capital, and the soldier typical of all kinds of unproductive labour. In the provision for modern war masses of capital must be sunk in specialised forms that cannot be used on the recurrence of peace. Economically the greater part of the expenditure is unproductive—that is to say, it does not replace itself by new values. The modern economist is apt to consider Adam Smith's distinction between productive and unproductive labour unreal. In war the distinction is vital. Who cannot see the difference between the labour spent on the trenches in Flanders and the labour spent in the original reclamation of the Low Countries from the sea? The expenditure of war is partly for the destruction of wealth, partly for the perversion of capital into forms incapable of use on the return of peace.

The immediate effects of the expenditure of new loans and new taxes must always be distinguished from the ulterior effects. The immediate effect is an increase of spending power—the ulterior effect is a diminution of capital. If the savings of the year are invested in war loans they cannot at the same time be invested in industrial undertakings. If the taxes on income are doubled, the annual savings must be less. War taxes do not cease with the war, and the interest on war loans is practically perpetual.

Some of the ulterior effects are not so obvious, but they all point in the same direction. The British Government has been universally applauded for the measures by which it upheld the credit of the country and prevented the outbreak of a financial crisis. Similar action was taken in other countries. All over the world there were a moratorium for old debts and new issues of paper money and credits for

new expenditure. The natural result of this great increase in emergency currency and in emergency credit, according to economic theory, would be a rise in prices—unless it was prevented by some superior counteracting cause. Such a counteracting cause would be found in the needs of war for greater amounts of currency and credits to carry on war industries and war operations. So far as this country is concerned, the supply of money and credits seems to have altogether outstripped the effective demand. The *Economist* of January 2 thus summarises the position: "To-day our banking position rests upon the credit of the Government, and the ease which rules in the short loan market is largely due to the outcome of the huge addition which has been made to the supply of funds by means of the issue of currency notes and the guaranteeing of loans and discounts." It is significant that in another article of the same journal it is pointed out that "our index number for the last month (December, 1914) shows a marked advance, and has reached the highest level recorded for years." The rise is specially marked in cereals. In spite of the command of the sea and of free trade and of great accumulations of wheat in London, the price of flour and of bread continues to rise. The contrast of the big loaf and the little loaf has found a new application. We are told that before the war the prices of foods had begun to fall, and that the indications were that prices generally would have been lower at the close of 1914 than for many years if peace had been maintained. As it is, prices are higher than for many years; or, in the concrete, the penny loaf or the penny bun is smaller.

In considering the rise in any group of prices, it is always difficult to say how much is to be set down to a general rise of prices due to monetary influences and how much is due to special causes. In the search for the present rise in the price of wheat, attention has been mainly directed to the supposed increase in the cost of the supply—the rise in freights, insurance, etc. It is forgotten that in all cases values depend not only on supply but on demand. By demand is meant effective demand, and effective demand

means a demand the desire element in which is backed by the power to pay in money. A great increase in the distribution of money in a country increases so far the immediate means of purchase. The returns of the mint, just issued, show that besides the great issues of Treasury notes for 10s. there has been an actual increase in the coinage of half-sovereigns, and in addition an enormous increase in the coinage of silver. Everything points to the masses of the people having more money to spend. This is, of course, most pleasing, but the worst of it is that the benefits of rising prices, due to expanding currency, are short-lived, and in the end such expansions are in general prejudicial to the masses of the people.

CHAPTER XIII

THE INFLUENCE OF DEMAND ON FOOD PRICES

(*January* 27, 1915)

THE price of English wheat in the week before the outbreak of the war was 37*s.* 3*d.* per quarter, and the latest quotation is over 56*s.*—that is a rise of 50 per cent. The present price seems still higher if compared with the price in January last year, when it ranged about 30*s.* The rise in English oats is greater in proportion than in wheat, the price having risen from 18*s.* 2*d.* last January to nearly 36*s.* at present—that is, practically double. There have been corresponding rises in most food prices except potatoes. As regards meats, the greatest rise has been in the imported kinds and in the inferior joints; that is to say, the cheaper kinds of meat have risen most. For a time the most marked rise in price was in sugar, but tea, apart from the tax (which is proportionately heavy on inferior qualities), has not risen appreciably. Fish and eggs have become unusually dear.

In other important articles in ordinary household expenditure a rise has taken place or is threatened. Coals have risen and are rising. A recent report stated that in Glasgow the state of the market justified a rise in house rents, but apparently the owners and the agents thought the time unsuitable on sentimental grounds. Neither in Glasgow, nor elsewhere probably, have house rents fallen owing to the war. The general result is that all round an ordinary income of so much a week or so much a year will obtain a good deal less than it did before the war. And yet, in spite of the rise in prices, which would naturally press most heavily on the poorer classes, there does not seem to be any exceptional distress for the middle of winter. On the contrary, many of the

signs of material comfort are above set fair on the national barometer.

So great and general a rise in prices, however, has its inconveniences and discomforts. People with fixed salaries, especially if they come within the full blast of the income tax, must perforce economise in something, if it is only in dismissing their servants or cutting down subscriptions. They have also the added discomfort of feeling that the rise in prices is increasing the incomes of the fortunate people who are interested as traders or carriers or speculators in the dearer things. Even the working classes in many cases find that their money wages do not rise so fast as their expenses, and in certain cases even suffer a fall. On balance, the rise in prices causes a shifting of burdens and of enjoyments that does not necessarily mean a nearer approach to ideal justice.

Whether the evil (if it is an evil) is in bulk sufficient to call for such a drastic remedy as an all-pervading and all-providing scheme of Governmental control is hardly worth discussing, because the difficulties in practice are far too great, even for the Germans. And in any case, unless the causes of the rise in prices are first of all made clear, any action of the Government is just as likely to be prejudicial as beneficial. Take by way of illustration one proposed practical remedy. The rise in food is attributed to the rise in freights, and the Government is entreated to increase the supply of ships in various ways so as to lower freights by competition. But at the same time we are told that the rise in freights is due to the scarcity of labour to work the ships, including the unloading. The port of London is so overcrowded that cargoes cannot be put ashore—they must await their turn, and that turn is a long way off. London is said to be overflowing with goods that cannot be distributed ; and taking wheat in particular, the supply afloat is said to be greater than this time last year. If, then, the Government is to add to the number and the activity of the ships, the labour will become relatively more scarce, the ports more congested, and the price of food higher.

Some people think that war prices are always of necessity

high prices, and that there is no more to be said. But, as pointed out in the first article of this series, history shows that of itself war does not make prices high, and that during the last two centuries there are about as many periods of war with low or ordinary prices as with high prices. Even if war does raise prices, the connection between war and prices is by no means obvious.

Why in war-time do some prices rise more than others and some refuse to rise at all, or even fall below the usual peace level? Why have English oats risen more than wheat? Why has the chilled and frozen beef of the Argentine risen more than the roast beef of Old England? Why are the prices of Stock Exchange securities so low? Why is cotton so cheap that in Egypt the Government is asked to restrict the area of cultivation, and the price of wheat so high in Britain that the Government is asked to give some kind of a bounty on production? If it is of the nature of war to raise prices, why should the State be called on to fix not only maximum prices in some things but minimum prices in others? When the supporters of the war theory of high prices are confronted by these conundrums, they reply that it all depends on demand and supply, which is no doubt quite true, but is equally true in times of the most profound peace.

The most wide-reaching principle affecting the relative values of all things that bear a price or are subject to monetary bargains of any kind is that the prices depend on the demand and the supply. There is only one general exception which arises when the prices are fixed by some external authority, as, for example, the Government or custom with the power of law. Even in this exceptional case, consciously or unconsciously, the external authority must pay regard to the conditions affecting the demand and the supply—the prices cannot be purely arbitrary. If the State fixes the prices too low the supply will not be forthcoming, as we are told is the case with the food prices in some parts of Germany. If the price fixed is too high the demand is killed, as we see in our own minimum prices for Consols.

The important point to notice is that in all cases we must pay regard both to the demand and to the supply. In the determination of all kinds of values both factors must always be considered. This elementary truth is constantly forgotten in cases of the highest practical importance. Even in theory for a long time it was not properly appreciated. There is always a tendency both in practice and in theory to hark back to some idea of "natural" prices that depend on something more fundamental than mere demand and supply. It is admitted that temporary changes may occur through sudden changes in demand or supply—*e.g.*, the closure of some great consumers' market, or conversely of some great source of supply. But there is always the idea that in time the prices will return to the "natural" level. If we ask, On what does this natural level depend? then we are told on the cost of production—that in the last resort all values must conform to their cost. If anything costs more to produce it will no doubt sell at a higher price, provided always that the demand is not checked or killed. But the whole history of economic progress shows how the cheaper thing has displaced the dearer, through the corresponding changes in demand. All prices depend on demand as much as on supply, and cost of production is only one of the elements affecting supply. In important groups of prices we cannot bring in the idea of cost at all. Take, for example, building land or the stocks that represent national and municipal debts. The idea of cost is in these cases quite inappropriate, and yet in both cases values depend on demand and supply. But even when the idea of natural cost value is given up people seek for some other "natural" foundation. They talk of intrinsic values. The chairman of a trust company tells his shareholders that after the war their securities will rise again to their "natural" level, and assert once more their intrinsic value. He would admit no doubt that a good deal would depend on the rate of interest; but what is the "natural" level of the rate of interest (say) so as to get rid of the risk element for first-class securities? Who would venture to answer this question in the face of the

history of our own Consols during the last twenty years? We are always brought back to the fundamental position that in every case of things that bear a price the relative prices depend on demand as well as on supply. In a sense wages are the price of labour. Who will say that the prices of the varied forms of labour depend on their costs of production? You can no doubt calculate the cost of rearing a child as you do the cost of rearing a calf, but when the child comes to earn a living his wages will depend quite as much on the demand for his labour as on the cost of his production. Again, interest is the price paid for the use of capital for a time. But who would assign the cost of production of interest-bearing securities as the determining element in their relative values? And so it is through the whole range of things that bear a price—we must always take account of the demand as well as of the supply.

When any sudden change of price is observed, the change must be due either to some change in the demand or in the supply, or in both. The outbreak of a great war is likely to produce very great changes both in demand and in supply as regards all kinds of things. But in all these cases both elements must always be considered. Even if the most noticeable change is a shortage of supply, still we have to look to the demand. It may be that coincidentally with the shortage of supply there is also an exceptional demand, as in Germany for copper. On the other hand, it may be that with a falling off in supply there may be a still greater check to demand, as in the raw cotton in this country.

In the search for the recent movements in food prices all the searchlights seem to have been turned on to the supply and the costs of production of the supply. The demand side has been overlooked. But there are several ways in which a change in demand consequent on the war may have raised prices.

Demand always depends on two elements—the desire to possess, which is only limited by satiety, and the means of purchase, which in most cases are limited by earnings. If people want anything more earnestly or greedily, they will

give more for it. If they have more money, equally they will go nearer to the limits of satiety. Unless they have the money, no increase of desire will raise prices. The late Robertson Smith used to say that in the East great famines were often accompanied by no particular rise in prices. The people died of hunger, but their demand was not effective. They had no more money than usual.

On both these sides of demand the outbreak of the present war has tended to raise food prices. Take first the money side generally, or the means of purchase. All the world over there has been a great increase in the amount of money. All the Governments have been making money and spending money. They have made the money by printing notes or postal orders, or by coining silver, or by creating bankers' credits or giving guarantees for such credits. In this country every kind of money has been increased. If bank-notes to the extent of forty millions or more are thrown into circulation, unless they simply displace some other form of money they must increase the spending power of the classes who get hold of them. The outbreak of war brings an excessive and sudden demand for certain kinds of labour. This labour is paid at higher rates, and in some cases works day and night. The cost of the upkeep of this labour and its dependants is more than in time of peace. The greater cost means that more money is put into circulation. But the people who get the new money spend it, and the increase in their demand for things raises their price. The fortunate producers and sellers of the things spend the extra wages and profits, and, in the words of the old song, "that's the way the money goes." When the new money has gone all round then there is that mystery fulfilled that is called a general rise in prices.

It is of course possible that the increase of money in different forms may have been counteracted by the contraction in other forms, or by the increased needs for circulating a new mass of things. Both of these possibilities seem of little importance in the present case. But apart from any general rise in prices of the kind just described the other side of demand--namely, the desire element—also points to the

probability of a rise in necessaries. If you send a million young men on long route marches they will probably eat a good deal more bread and meat, and they will wear out more boots and shoes than usual. The armies at the front and at home, under the British ideas of "necessaries," are no doubt amply provided, and the extra demand is no doubt allowed by the various middlemen concerned to have its full effect on prices. The rise in the price of boots and shoes can hardly be ascribed to congestion at the ports. The demand for woollen cloth is probably unprecedented.

One of the compensations of the war in this country has been the rise in the demand for unskilled and casual labour, and for some forms of skilled labour that before the war were earning wages below a reasonable standard of comfort. The standard of comfort has been raised for the time by better employment at higher rates, and the nominal money earnings have been converted into real wages by a greater demand for all kinds of necessaries. In the case of the very poorest, the fluctuating margin that always feels the pinch of short commons, a rise in the price of bread may, as Sir Robert Giffen observed, actually lead them to increase their consumption. The reason is that with the rise in bread they have less money left over for other things. It may be more satisfying to buy more bread with this little surplus than to take a diminished supply of some food that is more of a luxury. Changes in demand lead to all kinds of substitutions, with corresponding variations in the prices of the supplies demanded.

It is to be hoped that the Board of Trade will turn some of its inquiries into the varied problems that arise in connection with demand in war-time. It would certainly be surprising if the greatest war on record only affected values through disturbances in supply.

CHAPTER XIV

DEPRECIATION OF CURRENCY AND THE RISE IN PRICES

(*February* 17, 1915)

It was laid down by Machiavelli in his book on the art of war that it is preferable to conquer the enemy by starvation rather than by force of arms if the alternative is open, the former method being much more sure and in general less expensive in men and treasure. In modern times for starvation we may read economic pressure, of which starvation is the climax that is seldom reached in practice. Before it comes to the starvation even of the prisoners of war and of people of the occupied territories it is quite possible that Germany may feel that the economic pressure outweighs any possible gain from further resistance. One of the less obvious forms of economic pressure is the monetary influence. The facts bearing on the monetary situation can only be appreciated if the meaning of the terms in which they are expressed is understood. Depreciation naturally suggests something decadent and uncomfortable, and we are all pleased to read in the papers from time to time that the German currency is depreciating. On the other hand, the depreciation of the Russian currency is put down as a point against the Allies. If anyone should suggest that the currency of the United Kingdom is depreciating or in any conceivable danger of depreciation either his patriotism or his judgment would become suspect, the name of depreciation being so very unpleasant.

The term depreciation, however, as applied to money has two distinct meanings. One of these meanings is quite harmless from the patriotic point of view. With this mean-

ing we may speak of depreciation of our currency without fear of the censor. This is the kind of depreciation that with another name is at present attracting the attention of the public in general and of a committee of the Cabinet in particular. Our monetary standard on which all the other forms of our currency are based is the pound sterling or the golden sovereign. Everyone now knows that since the outbreak of the war the pound sterling has lost in purchasing power. The very meaning of a rise in prices is that a pound or a shilling does not go so far as it did. Such a fall in the purchasing power of the pound is the same thing as depreciation in the first of its meanings. It is the meaning of depreciation that is applied by writers on finance not only to particular national currencies, but to gold itself considered as the basis of these currencies. When we speak of the depreciation of gold we mean a general rise of prices in terms of gold—that is, a given weight of gold gets less of any representative group of things. It is always necessary to keep in mind the distinction between general prices and the particular prices of particular things. The distinction may be made clear by an illustration from yacht-racing. If all the yachts begin to show slackened speed we naturally suppose it is due to some cause affecting all more or less in the same way, such as the force of the wind or tide. If there are changes in the relative positions, then we ascribe it to the sails or the men or the build or the luck of getting some special capful of wind, and so on.

In the same way with prices, if we find that on the average all of them have gone up, then we ought to look for some very general cause or causes that are likely to affect all the things in the same direction. When all the yachts begin to sail on the average about twice as fast as they did, nobody supposes that all the crews have suddenly waked up or that the art of the yacht-builder or of the skipper has at last been revealed. But with a general rise in prices the invariable practice of the practical man is to look to the particular causes affecting the particular things, taking each thing by itself. In the debate on the rise in food prices in the House

of Commons the attention was entirely devoted to the special causes affecting the food. Some progress was made towards a solution by the Prime Minister, who admitted that we must look at demand as well as supply. Hitherto most people had insisted on the shortage of supply as the principal cause, with a special leaning to a shortage caused by the nefarious practices of American corner-men or British shippers. In face of the Board of Trade returns no one can say that there is an actual shortage of supply; but the Leader of the Opposition suggested that the real cause of the rise was the fear of a shortage, this fear being taken hold of by the speculator so as to make the flesh creep of the prospective consumer, who thinks of being made to fast in the long days of June.

The Prime Minister made an advance on the shortage theory by bringing in some of the influences of demand, but he never got beyond the special influences of the special demand. He never supposed or stated that the rise in food prices is in any way part of a general rise due to general causes.

That such a general rise has in fact taken place during the period of the war is evidenced at once by a reference to the *Economist* index numbers. These index numbers are based on groups of forty-four representative commodities, and some of them have gone down in price, *e.g.*, cotton. It is as if forty-four yachts had greatly increased their average speed, though one or two had dropped out of the race and one or two had gained on the rest. The *Economist* calls the rise "portentous." The general rise on the average of last July is 20 per cent., and the rise on the average of the basic years of 1900–05 is as much as 36 per cent. No examination of the special causes affecting particular things will account for these general movements, though they will explain why some things have felt the movement more and some less.

When people are forced to recognise that a general movement has been in progress that must be ascribed to some general cause, they are content to say that it is all due to the war, but, as observed before (Chap. XIII.), they do not

explain why it is that war raises some things and depresses others, and still less do they recall the fact that wars are not always characterised by rising prices on the average.

The Prime Minister compared present prices with the prices that prevailed after the conclusion of the Franco-German war, 1871–75, and showed that prices then (except coal) were higher than at present. But he did not mention that for twenty years thereafter there was a continual decline, shown in the *Economist* by a fall from 126 in 1875 to 88 in 1895 (compared with the basic average of 100 in 1845–50). This tremendous fall was unquestionably connected with causes affecting the monetary standard, that is, gold itself, as, for example, the falling off in the supply and the increase in the demand through the demonetisation of silver.

In the same way the rise since 1895 has been naturally ascribed partly to the very great increase in the supply of gold and partly to a corresponding inflation of credit and representative money all the world over. These monetary causes are certainly what Bacon used to call *verae causae*, that is to say, they are capable of producing the effect assigned. They are not imaginary or negligible.

When we are confronted with the rapid and general rise in prices since the beginning of the war, which is the more remarkable as it set in in face of a continuous fall for the year preceding the outbreak, we ought to consider if there has been any change in the monetary position likely to assist in bringing about such a state of things.

The first reference to the demand and the supply of gold seems to suggest that with the war we ought to expect rather a fall in prices than a rise. With regard to supply all the great foreign banks have taken to hoarding their gold, as if that were the height of financial wisdom. The Bank of England has hitherto been in the fortunate position of creditor for gold as compared with other countries, but everyone remembers how, at the beginning of the war, we were all told it was our duty to put all the gold we had in the banks. If then, the outbreak of war was the signal

for all the banks to get gold and keep it, it is not easy to see how the rise in prices can be ascribed to any increase in gold money in circulation. On the contrary, even if we neglect altogether any idea of private hoarding, the action of the banks alone would lead us to expect a fall rather than a rise in prices. The gold hoarded in banks cannot affect prices unless it is used in some way, and it is certainly not used in circulation when it is hoarded. But when we look to other monetary causes (apart from the actual circulation of gold), then we find abundant reason for expectation of a rise in prices. Any gold withdrawn from circulation has been more than replaced by other forms of legal tender. In the United Kingdom, especially when we look to our very highly-developed banking system, the increase in the actual amount of legal tenders has been enormous. The postal orders were only withdrawn (or rather notice of withdrawal only was given) last week. How much of this legal tender was in use we have never been told. The Treasury notes reached over £38,000,000, being regularly added to every week until the end of the year. How the notes were issued, or why they were issued, again we were never told.

At first it was said they were to provide the banks with emergency currency, but according to the accounts published, the banks took only a very small amount at the beginning. It looks as if the Government printed the money, and spent it in meeting the cash expenses necessary for the war. Perhaps such a course was inevitable—but that does not get rid of the consequences. The notes were effectually thrown into circulation side by side with the postal orders and an abundance of new silver. At the same time once the shock of the beginning of war had been neutralised, the banking system of the country returned to its normal health. It is not as if there was a general refusal of everyone to take the cheque of anybody else—it was not as if we had suddenly acquired the French habit of paying for most things in bank-notes or coin. The fall in the Bankers' Clearing Returns is probably accounted for by the closure

of the Stock Exchanges and the restriction on dealings of a speculative character.

All former experience shows that if in any country a large addition is made to its legal tender it is followed or accompanied by a rise in prices. A certain increase is no doubt required with the growth of trade and population, but any sudden great increase is quite different.

It may be objected that the Treasury notes and even the postal orders were always convertible into gold on demand (or to silver coin on a parity with gold). We are not like the miserable Germans, who before the war (by way of preparation) imported gold at a loss to hoard in the Reichsbank, and when war was declared promptly made their notes inconvertible. We, on the contrary, made a declaration that anyone could take a postal order to the Bank of England and get it changed, and so of the Treasury notes. But as for giving facilities to make the convertibility effective all over the country, the very reverse was the case—the banks were encouraged not to pay out gold. The fact remains that six months after the declaration of war the London money market was in a state of otiose repletion and the channels of circulation were filled to the brim with emergency currency.

Since the beginning of the year there has been some contraction, but there is an old proverb that you do not cure the wound of the arrow by unbending the bow, and it will take time and discomfort before the contraction can become effective.

The natural result that might be expected from such an inflation of currency is confirmed by other recognised signs. Inflated prices encourage imports and discourage exports. A glance at the latest returns of the Board of Trade shows that the values have risen largely, so that the aggregate for January is practically the same as last year in spite of the war. But the exports tell a very different story, their aggregate value being 40 per cent. less as compared with a shrinkage of imports of only 0·8 per cent. If this disproportion continues, the London money market is likely to be enlivened

by the exit of gold, though the gold at Ottawa (or elsewhere) at the credit of the Bank of England may act as a buffer for the time. But one thing is certain—a continued excess of imports over exports, due to inflated prices, will lead to a demand for gold. If the demand for gold is not met, the notes become inconvertible. As compared with gold, they suffer a specific depreciation—a pound note will not be accepted as readily as gold. Which things, happily, have already come to pass in Germany—the general depreciation of the notes shown by the rise in prices has become marked as compared with gold; and the foreign exchanges show a specific depreciation of German currency of over 10 per cent. This second kind of depreciation is for the time of no interest to anyone in this country, and it is to be hoped that the dislocation of the foreign exchanges may never become a matter of popular concern.

In conclusion, it may be said that so far as the present rise in prices is due to an inflation of the currency, we cannot expect any return to a "natural level" until there is a corresponding effective contraction. During the last two weeks there has again been an increase, and the reversing process is always difficult, especially in time of war.

CHAPTER XV

LABOUR AND THE WAR

(*March* 4, 1915)

"Die Lohnfrage ist eine Culturfrage."—Brentano.

It may, perhaps, seem ridiculous at the present time to take as the text for an article on Labour a little bit of German, which translated means—"The wages question is a question of Culture." "The wages of Kultur is death" would seem a more appropriate sentiment to most people. The choice of the text admits of a personal explanation, and also serves to throw light on the general question of the attitude of British labour to the war. The first book I published on an economic question, so far back as 1878, dealt with the "Effects of Machinery on Wages," and I took this sentence as a motto so as to indicate in my view the breadth of the problem. The first difficulty that arose was one of interpretation. Even the meaning of machinery is not obvious. Are we to include the machinery of transport and communication—*e.g.*, telegraph wires and railways? But the proper meaning to be given to wages is still more difficult. Are we to mean by wages simply the price of labour, as if labour were a commodity to be bought and sold just like any other commodity? And if this is the meaning, what is to be the unit of measurement? Are the wages to be reckoned by the hour or the day or the year? Or, again, are we rather to take account of the work done or the task accomplished, and then how are we to get any common measure of the "quantity of labour" involved in these varied works and days? The price of any ordinary thing—*e.g.*, a pint of beer—is quite definite, but the price of a "quantity of labour"

seems only to admit of indefinite interpretation in any complex society.

The difficulty may be put in another form. Everyone now is more or less familiar with the distinction between nominal and real wages. By nominal wages we mean the amount of money received in exchange for the labour, and by real wages we mean in the first place what the money will fetch in terms of necessaries, comforts, and luxuries. But when we look into real wages more carefully, we soon see that the meaning must be still more extended. Honour, said Adam Smith, forms a great part of the reward of all honourable professions. Anyone on the look-out for any kind of job will take account not only of the money wages and the hours, but of all the things—honour and the rest—which go to make up the environment or the circumstances of the case. The wages may be all right, and the hours, but if other things are wrong the case is altered. It comes, then, to this, that if by wages we are to mean the full reward of labour for the sacrifices of labour, we must take account of all the things that affect the conditions of labour. And that is what the German professor meant by saying that the wages of labour is a question of culture—not merely one of bread and butter and money. The book of which this sentence was the conclusion was a study of the history of the origins of Trade Unions in England, "the classic home of liberty," as he called it. For many years this book was the standard work on the subject both abroad and in Britain.

There still remains one other difficulty of interpretation whether we are considering machinery or war. What is labour? In dealing with questions of labour, Adam Smith, who was by far the most practical and the broadest of economists, took his illustrations from all kinds of labour—lawyers, churchmen, professors (he was one himself), and, in short, from any kind of the gainful occupations of mankind. In dealing with labour in relation to war there are advantages in taking this wide interpretation. In war as in machinery we see at once that ordinary manual labour is not the only kind that must be considered, especially in the modern army.

Military organisation, if it is to be effective, demands the highest forms of skill and endurance far more than in the ordinary business of life. Probably that was what Adam Smith had in view when he said that war is the noblest of all arts. No one is likely to overlook the importance of the higher grades of labour in war, and everyone would admit that they furnish the best examples of the case where honour forms the greatest part of the reward. But in war as in machinery there are advantages in taking separately the wages of labour in the sense in which wages are contrasted with profits and with professional fees or salaries, and the labour is manual labour of different qualities as regards skill. What, then, is the effect of war, or more precisely of the present war, on wages, and specially on the wages of ordinary British labour?

The letter recently sent out by the Parliamentary Recruiting Committee to householders was accompanied by a very detailed statement of the money wages and the compensations to be obtained by those who enlist for the period of the war. The Germans will no doubt see in the comparative generosity of the terms offered another proof that the British Army is an army of mercenaries. If the recruiting should in any way fall short of the requirements they will argue that the price offered to labour was not high enough, and that in the choice of a job the British working man only thought of the money wages. They will comfort themselves with the reflection that an army of mercenaries is not to be compared with an army that is a nation in arms impelled only by the sense of duty.

The question of "mercenaries" against conscripts—for that is what it comes to—raises very interesting problems both of morality and of military efficiency. The appeal to history gives conflicting results according to circumstances. When the Germans say we are mercenaries they use the term of course as a term of abuse. It is easy to show that in our case as a term of abuse it is inappropriate. Even the Germans would admit that the Regulars, that is to say the professional mercenaries of the British Army, can be com-

pared with any equal number of any conscript army with advantage. They are superior in efficiency and superior in *moral*. The latest testimony is that of Viscount French. It is a matter of history that Wellington's armies were made up for the most part of the lowest ranks of the people—the words used to describe them were much less polite—but under his command in *morale* they were models compared with the conscripts of modern Germany.

The German is by nature a bookworm, and he gets his ideas of mercenaries from books and bookish traditions. From other evidences we know that the modern German has been giving much study to his Machiavelli. He has used for his purpose the writings of that eminent man even in the same way as the Devil may quote Scripture. We know that the great Frederick attached a high value to Machiavelli's treatise on the art of war, and we know that German modern diplomacy is based on the "Prince." Machiavelli, like all the great Italian writers, was a devoted lover of Italy, and looked with horror on the way it was broken up into warring little States, and lay open to the incursions of the hated foreigners. The root of the evil he found in the system of mercenaries that was universal at the time in that country. All the different States hired mercenaries when they wanted them, just as they hired masons and others for public buildings. The leader of any body of mercenaries sold his services frankly to the highest bidder. The various bands had a kindly fellow-feeling for one another, and in the course of time, under these kindly feelings, the game of war became as much a game and much less dangerous than present-day professional football. Your proper mediæval mercenary was a horse soldier, and so encased in armour that he was only in danger of death by falling from his horse and being trampled on. Machiavelli describes a battle for a bridge that was several times taken and retaken, and at the end of the day the total loss on both sides was one man crushed under the horses' feet. But in those days the game of war was by no means a game to the spectators, or even to those who paid the professionals. When a mercenary army invaded any

territory it laid it waste exactly as the Germans had laid waste Belgium. A large part of the real wages of these old mercenaries was in plunder, and they took it; a large part of their pleasure in war was in what the Germans now call frightfulness, and they murdered and ravished and burned out of pure lust. But they never pretended they used the frightfulness to bring the war to an end. There was nothing they wanted less. As soon as one war was over they had to look for another. A time of peace was a time of misery to these professionals. Morally they were a poor lot. Yet they had their qualities; if not religious, they were at least superstitious—they did not burn or plunder churches or kill priests, though in the sack of a city such things might happen. They honourably observed the unwritten laws and customs of war. In other times there were other kinds of mercenaries—Gibbon is full of examples. In his famous chapter on Attila and the Huns he remarks on the imprudence and incompetence of the Roman Emperor who did not hire for his defence against the Huns the mercenary hordes of Asia. Incidentally he says that the cheapest of all things to buy is the courage of the common soldier.

To what does all this tend? What is the bearing on present recruiting? The bearing is this—If those who enlist in the United Kingdom for this war are to be called mercenaries, they are very different from the "mercenaries" of recorded history.

With the British recruit for the period of the war the wages part is the smallest part of the inducement. It is only the decisive part when the wider self-interest that is centred in the family relationships is aroused. He is more concerned about his dependants than himself. If an intending recruit were to sit down in a cool moment and balance up his shilling a day (with the board and lodgings likely to be forthcoming in the trenches), if he were to take account of all the hardships and all the chances of frost-bite and wounds and death, to say nothing of the rigid discipline night and day, he would certainly conclude that it was not good enough. If he happened to be a real selfish person he might well con-

sider that the dearth of labour caused by the enlistment of others gave unequalled opportunities for having a good time at home in almost any kind of man's work from that of a dock labourer upwards.

And yet he moves, and he moves cheerfully towards the front. Under the conditions the success of the voluntary system has been amazing, and it has borne a strain which was never contemplated with apparent ease. It is impossible to put one million of men in their fullest vigour under arms without drawing them for the most part from the masses of ordinary wage-earners, and when the million grows from one to two and three millions, still more does it represent the better part of the manhood of a great working nation.

This ready response to the call to arms on the part of the great masses of the people can only be ascribed to a sense of duty. "Mankind are capable of a far greater amount of public spirit than the present age is accustomed to suppose possible." So wrote J. S. Mill about the middle of last century. And to the present age it has again come as a discovery.

It is to be hoped that this recognition by the working classes who have enlisted for the period of the war of the sense of public duty will not be counterbalanced by too great regard to self-interest on the part of those who are left behind. The situation is one of great difficulty. There is no precedent. On the side of labour there is owing to the war in many important industries a scarcity of labour, and at the same time an exceptional demand. The prices of the things of most importance in the workmen's budget have risen, and the same money wages will not go so far. Directly or indirectly the great paymaster is the Government, not only of this country, but of almost every other country with which we are not at war. And in war time every Government is a spendthrift, and, according to all experience, the British Government is the greatest of all spendthrifts. When the working classes see the credit of the State pledged for all kinds of business, and when they hear of the exceptional profits of fortunate contractors and agents and middle-

men, naturally they expect to have a share of the Government bounty. It is in a case of this kind that any particular incident in the way of profit—*e.g.*, the unlucky timber brokerage—is apt to be magnified, and what is exceptional (it is to be hoped) is taken as an average. Naturally then labour is inclined to ask for a rise in wages. On the other side the employers of labour may point to a rise in the cost of materials and of coal and of transport, to the loss of old markets and the difficulty of adaptation to new, to the extra risks and the actual delays and all the other causes that the people most concerned have described in the most realistic manner.

The situation is eminently one for the methods of conciliation. The method of compulsory arbitration depends for its efficacy entirely on the power of the compulsion. The real force at the back of it must be public opinion as it cannot be enforced under present conditions by imprisonment and still less by martial law. On the other hand, an impartial inquiry by a Conciliation Board *ad hoc* with a simple recommendation would probably suffice. An appeal to the patriotism on both sides ought to be sufficient to accept this solution. It is no use admiring the public spirit of those who volunteer for the front if those left behind look only to their own money interests. Any strike or lockout in the period of the war is absolutely indefensible.

It should be remembered that the greatest strikes have taken place for what is called matters of principle. The sympathetic strike is in most cases undertaken with the idea of immediate pecuniary loss. In civil life a great strike is the nearest approach to war. The people of this country, "the classic home of liberty," have struck against the militarism and despotism of Germany. The root principle of this great sympathetic strike is liberty. In a way the German professor little thought of, the wages question has become a question of Kultur, of Kultur against liberty.

CHAPTER XVI

DEPRECIATION OF THE CURRENCY

SPECIFIC DEPRECIATION

(*Wednesday, March* 17, 1915)

In a former paper * attention was called to the depreciation of the currency in this country in the course of the war in the sense of a general loss in purchasing power of the pound sterling. That there has been depreciation in this sense—that is to say, that there has been a general rise in prices—it is impossible to deny, and it is not necessary to recall the main facts of the evidence. It is, however, interesting to observe that the arithmetical fact of depreciation continues to be confirmed by the usual consequences. The returns of the foreign trade for February show again excessive importation and deficient exportation as compared with last year. With the high prices imports are naturally stimulated and exports checked. Again, the difficulties in the readjustment of wages have continued, and they are no doubt to be largely attributed to the general rise in prices, especially as affecting workmen's budgets. The readjustment of wages is always one of the troubles consequent on a general rise in prices. Another symptom is the decline in the reserve of the Bank of England. The absolute amount is larger than it was last year, and is above the average of many years, but it is not the absolute amount but the proportion to liabilities that counts, and the proportion has been rapidly falling, being only $24\frac{1}{2}$ per cent., as against $34\frac{3}{8}$ last December, and $49\frac{1}{8}$ this time last year.

It cannot be denied that there has been a general rise in prices, which is exactly the same thing as a general deprecia-

* Part II., Chap. XIV., p. 255.

tion of the currency, but many people object to the use of this latter phrase. They prefer to indicate their confusion of thought by saying that the rise in prices is the "natural" result of the war. On this view prices in war-time simply rise because "it is their nature to," like the dogs that delight to bark and bite, and the opium that has the *virtus dormitiva*, whose nature it is to dull the senses.

Apart from this natural sort of fatalism in war-time, there is the ingrained belief that, whatever else may be the cause of the rise in prices—*e.g.*, varied kinds of war-inspired wickedness in the classes or the masses—there is certainly nothing wrong with the currency. It is part of the common British heritage that notes that purport to represent the pound sterling cannot be depreciated, such and so great is the credit of the British Government and of the Bank of England.

In the great Napoleonic wars the people of this country had the same belief, but in time the notes of the Bank of England were depreciated some 30 per cent. By this is meant not simply that there had been a general rise of prices to about that extent (for, in fact, it was a great deal more), but that £130 had to be given for the gold in a hundred sovereigns. In other words, there was a specific depreciation of the notes relatively to gold.

It is the object of the present paper to explain the nature and causes of specific depreciation (compared with gold) and its connection with general depreciation (or fall in general purchasing power). Specific depreciation generally becomes first noticeable in making foreign payments. Under normal conditions, throughout the commercial world all the various currencies of the different nations are expressible in terms of the gold which they will command. The general rule is that foreign payments have to be made by transmuting the corresponding debtor currency into gold (or the right to gold), and the creditor country can again convert this gold (or right to gold) into its own currency. Russia, for example, collects its revenues in roubles, and to make a payment in this country the roubles must be transmuted

into the corresponding gold value in terms of sovereigns (or the right to claim sovereigns). If the Russian debtor has to pay 115 roubles for £9 sterling, payable in this country, where in the normal course of things he had to pay only 100 roubles, there is a specific depreciation of the rouble of some 15 per cent. The loss to the Russian debtor is obvious if he had not allowed for the depreciation, and if the depreciation fluctuates there are always difficulties in making the allowance.

This example shows the difference there is between specific and general depreciation. It does not follow that because for foreign payments the Russian rouble has depreciated (*e.g.*, in its command over the pound sterling), it has therefore depreciated to exactly the same extent as regards its general purchasing power in Russia. The evidence available goes to show that in Russia there has not been any great rise in prices. And it is obvious from the nature of the case that the general level of prices in such a vast area cannot fluctuate with every movement in the price of foreign gold in terms of the rouble.

Early in the war Germany began to suffer both from a general and from a specific depreciation of its currency. There was a general rise in prices, and also a lessened value for the mark in its command over foreign currencies. By the end of November the German mark had depreciated in its command over gold in New York and Amsterdam about 10 per cent., and since then the depreciation has shown a fluctuating increase.

In the United Kingdom the general depreciation shown by the rise in prices has not been accompanied by a corresponding specific depreciation as regards foreign currencies. Up to the end of October, indeed, it was the New York dollar that was depreciated as regards the sovereign payable in London. But for some time now the rate of exchange has been such as in normal times would have meant the shipment of gold from London to New York. The pound sterling has certainly not suffered any specific depreciation like that of the mark or the rouble, but it appears to be

hovering "on the margin of doubt"—the test which the modern economist considers of such importance.

Those who say that the general rise in prices in this country cannot be due to the currency point to the fact that our currency has suffered no specific depreciation. It is to be hoped that this reason may still serve their purpose.

In the initial stages, however, especially in times of disturbance, the two kinds of depreciation depend on different causes, and may even move in different directions. At the outbreak of the war most foreign countries had to make on balance payments in London. Since they were all most reluctant to send gold, they were willing to pay in their own currency fancy sums for the right to command gold in this country. On August 1 it is recorded that a cable transfer on London cost in New York seven dollars, whilst under normal conditions no one would have given so much as five dollars. This panic rate was, of course, only temporary, but it was not till the first week of November that the relations of the dollar paid in New York to the pound payable in London came within the normal limits. But during this time when the pound sterling was appreciated (instead of being depreciated), as regards foreign currencies, it was losing its purchasing power in this country through the general rise in prices. It is probable (as argued in a former paper *) that this general rise in prices is partly due to the general inflation of currency and credit. The fact that England was a great creditor country, and was also calling in interest formerly left abroad for investment, and checking the usual flow of its capital abroad, made the conditions favourable for the appreciation of the pound sterling in terms of these foreign currencies.

But although in the initial stages there may be a general depreciation without specific depreciation as regards foreign payments, in the course of time there is an interaction between the two. Suppose that in England the general rise of prices continues, then so far it becomes a good country to sell in and a bad country to buy from. As a consequence

* Part II., Chap. XIV., p. 255.

the balance of indebtedness turns against the country so far as trade is concerned. Instead of other countries—*e.g.*, the United States—being in urgent need of making payments in England, the opposite is the case, and England is in urgent need of making payments in the foreign countries. Consequently the English debtor is willing to accept less of the foreign currency for his pound. But there is always a limit to the fall in the amount he will take. If he sends the sovereign itself, the gold in it will always obtain the full normal value in the foreign currency. Accordingly, when the value of the English pound estimated in foreign currency falls below the par value *plus* the cost of sending the actual metal, gold is likely to be sent.

When this stage has been reached, then the difficulty has to be faced—Where is the gold to come from? The great mass of wholesale transactions are effected without the actual use of gold or even of bank-notes. Within the country the chief form of the circulating medium is the cheque which is drawn against a credit in a bank. All these cheques in the last resort give the receiver the right to claim gold from the bank. In the last resort, then, anyone with a credit on a bank can obtain gold for transmission abroad. It follows that with a continued adverse balance of trade a drain will set in on the ultimate banking reserves. If the Bank of England (or the Government) follow the example of foreign countries and decide to hoard the gold, then, unless by some method of borrowing abroad the need for the remittance of the gold is avoided, the pound sterling must suffer a specific depreciation, even as the German mark or the Russian rouble under similar circumstances. It is, of course, possible that the Banks of France and Russia may liberate some of their masses of gold for the benefit of England, and apparently some arrangement of this kind was mooted in the conference in Paris. On the face of it, however, it seems doubtful if these Banks will go very far in the depletion of their hoards. Both France and Russia have issued great amounts of inconvertible notes, and on the restoration of peace they will no doubt attempt to revert

to convertibility as soon as possible. They may want their hoards for this purpose. But for a long time past the hoarding of gold by foreign banks has become a kind of obsession. The maxim that a reserve of gold ought to be accumulated in ordinary times for use in an emergency has been strangely perverted into the maxim that in times of stress gold ought to be hoarded for liberation when the stress has passed. This extraordinary perversion of the use of a gold reserve finds a striking illustration in the recent speech of Dr. Helfferich on the provision for the German war expenses. He said: "The maintenance of Germany's stock of gold was more important than the value of the German mark abroad." At the same time we also know that every kind of effort is being made in Germany to collect all the gold possible in the country for adding to this central hoard. Gold is not to be used as currency, gold is not to be privately hoarded, and everyone is to take the inconvertible notes without hesitation. If, then, the gold is not to be used for foreign payments nor for internal currency purposes (the two legitimate uses of gold money), for what reason is it to be piled up? It would, no doubt, be useful as a basis of the war indemnity to be paid by Germany, but Dr. Helfferich tells us Germany expects to receive and not pay an indemnity. But whatever the reason may be for hoarding gold, the case of Germany is not peculiar. In the face of this general devotion to hoarding by foreign banks, it remains to be seen how long London will remain a free market for gold. The Government has this last week stopped the "ear-marking" of gold for the redemption of Treasury notes, though the amount of notes issued has again been increased. From the recent debate in the Commons it was apparent that the gold "ear-marked" against the notes was to be used for any emergency that might arise. If the $27\frac{1}{2}$ millions of "ear-marked" gold is to be used for foreign payments, it may soon run away so rapidly that the method of hoarding may be preferred. At the same time, the actual convertibility of the notes within the country may be endangered, and if the issues

are still further increased the rise of prices will be intensified.

The people of this country may continue to accept the rise in prices as part of the natural burden of war, but any specific depreciation of the pound sterling, or, what is the same thing, any doubt as to London being able to meet any claims in gold, will have serious consequences. The *Economist* of the 13th instant has a pertinent quotation from the New York *World* on the American dollar. It is there stated that " the American dollar is now at a premium in the currencies of every principal country in Europe. . . . International trade for years without number has been financed through London. Credit in English pounds sterling has been the standard and *desideratum* of the world's commerce. This is now turning to New York and in terms of the dollar." The American writer may be a little previous, and New York certainly made a very poor beginning on the outbreak of the war as the world's banker. But it seems time that in finance as in other things this country should begin to realise that we are engaged in the greatest and most expensive war on record, and that there are very real limits to the extension and inflation of public credit.

CHAPTER XVII

COMPENSATION AND PROHIBITION IN WAR-TIME

(*April* 28, 1915)

After nearly nine months of war we are told that the great mass of the people do not realise that we are at war. The complaint is sometimes made *à propos* of some particular survival of the habits of peace such as horse-racing; sometimes as regards the reluctance to undertake the military burdens of war on the voluntary system. But the complaint is justified in a much larger sense than is suggested by any particular instances. The fact is we have retained the peace habit as regards principles and ideals, and we have forgotten that from the very meaning of war even some of the most fundamental principles of peace are not applicable.

Take first the principle of personal liberty. It is universally recognised that one of the first duties of the Government is to protect the liberty of the subject. Individual liberty is, needless to say, the corner-stone of the system of political economy founded by Adam Smith. Those who (like the present writer) still profess the principles of Adam Smith are supposed to be extreme supporters of the principle of liberty.

Even those who advocate Socialism, in any practical sense, argue that in the socialist state there will be a greater amount of real personal liberty than under present conditions. John Stuart Mill, whose leanings to socialism are well known, said that the ultimate test between the systems of individualism and socialism was to be found in the degree of liberty actually afforded under the two systems.

As a working practical principle of State action under ordinary conditions, this idea of liberty has much more force

than is commonly supposed. It is seen in an extreme form in the claim of liberty to strike even in services and industries of the first importance to national life, *e.g.*, transport and coal mining. Out of deference to this idea of liberty even in peace-time the national safety has been imperilled. The worker is ready to recognise restrictions on his liberty imposed by his own Trade Union, but not so ready if the restrictions are imposed by the State. In the same way in the matter of consumption, people resent interference with their liberty in eating and drinking, even if the regulations are supposed to be in the interests of the consumer. The old sumptuary laws have been abandoned, just as the old laws that compelled attendance at church. There is no question that in the course of progress, in spite of the interferences of recent years, the real liberty of the subject has on the whole been greatly enlarged.

But however admirable this principle of liberty may be in time of peace, in time of war it must be largely curtailed. The degree of liberty that may be allowed to the subjects must be subordinated to military requirements. It may be laid down as a counsel of perfection that the minimum of interference should take place, but in the case of doubt the claim of war must prevail, and prevail instantly. The whole power of the State must be directed to the speedy and successful ending of the war. The smaller liberty, *e.g.*, of striking, or profiteering, or drinking, or shirking, etc., must give way to the larger liberty of individuals within the State, to liberty of the State itself amongst other States.

Simple as this reasoning may seem, the conclusions that follow are not so readily accepted, such is the force of habit. The first conclusion is that, if necessary, conscription must be submitted to, and the necessity must be judged of not by the possible conscripts, but by the Government and its military advisers. To say that conscription is an interference with the natural liberty of the subject is irrelevant in a state of war. At any rate, it is a less infringement than the invasion of the country or of its rights by an external enemy. If the Government of this country undertakes to say that

conscription is necessary, the proposal will meet with no opposition, from responsible statesmen.

Next, it follows that if so great an infringement of natural liberty as conscription is to be admitted, any lesser infringement necessary for the supreme end must also be admitted. If universal conscription is within the rights of war, *à fortiori* any lesser compulsion is included. The State in war-time has the right to demand the services of all whom it may require.

But here we are apparently brought into conflict with another of the principles of peace, that we find it so hard to abandon in time of war—the principle, namely, of equality. This principle of equality is not so generally or intensely admired as is the principle of liberty. The British mind, in particular, has never been much inclined to systems of levelling. There are no doubt here, as elsewhere, people who are always quite willing "to take out their sixpence and pocket your shilling," but the "yearnings for equal division of unequal earnings" are not very widespread or intense. Jeremy Bentham, who has probably had more influence on the course of legislation for the last century than any other writer, and who is the reputed father of the principle of "the greatest happiness of the greatest number," declared that the passion for equality has its root not in virtue but in vice, not in benevolence but in malevolence. Bentham, however, was a cantankerous philosopher, and in some forms no doubt the principle of equality is to be placed on a footing with liberty as one of the great ideas of progress. Equality before the law is a great text; so is equality of taxation; though both present great difficulties in the interpretation. There is also no question that in recent years, by the adjustments of taxation and expenditure, we have made great strides in the direction of greater equality in the distribution of wealth. Equality of opportunity is one of the most popular watchwords of the present-day reformer. But, as with liberty, whatever the moral value of equality in time of peace, it must take a second place in time of war. The business of war cannot wait until all the claims for equal treatment are

adjusted. Equality is as inappropriate as liberty as the basis of military discipline, and in modern war every member of the State must submit more or less to military discipline. Although this reasoning cannot be objected to the conclusion is only admitted with reluctance, so great is the force of the peace habit.

Some weeks ago the Chancellor of the Exchequer complained that the output of munitions essential to the successful conduct of the war was hindered by the drunkenness of a small minority. It is true that the smallness of the minority was emphasised, but so also was its power for evil—for drink was said to be the strongest of all our enemies. Let it be supposed that the charge was true and the evil as serious as was stated. The obvious duty of the Government was to abate the evil by any degree of compulsion that might be necessary. Where was the difficulty? The anarchical liberty of a few was to be sacrificed to the wider, truer liberty of the many. In recent years compulsion has become a blessed word; it is twice blessed, it blesseth the bureaucrat who gives it and the patient who takes it. We have only to recall the double blessing of compulsory insurance.

The real trouble was not with the survival of the principle of liberty but with the survival of the principle of equality. This malevolent principle (the adjective is Bentham's) made people think (or say) that if the drinking of the munition workers was to be restrained, then by the principle of equality equal restraints ought to be imposed on everybody else. To such lengths was this search for equality carried that in the midst of the greatest war on record, when all the energies of the Government ought to be concentrated on the efficient conduct of the war, they were asked to consider and decide between large schemes for the prohibition or nationalisation of the whole drink traffic. It is true that the proposals for prohibition were also supported on other grounds, but the beginning was to be found in this idea of equality—and therein also is to be found the beginning of the end.

For this principle of equality came up against another

principle, which in practice has often shown itself stronger than either liberty or equality. This is the principle of property, with the correlative moral right of compensation for disturbance. Out of deference to these ideas we were told that any regulation of the drink traffic ought only to be put in operation with carefully devised compensation for all the vested interests concerned.

There can be no question that the development of the principle of property has been one of the great strands of economic progress, and it is part and parcel of the modern State although the crimes committed in the name of property have been and are, it is true, as numerous as the crimes of liberty. As one of the greatest of jurists said, the right of property is a terrible right, but it is perhaps necessary. On the ordinary view of compensation in times of peace, the proprietary rights that have been suffered to grow up by the State in the liquor trades and industries have as good a claim for compensation as other forms of lawful property in case of extinction or diminution. And as Mill argued, any question of compensation should turn, not on the strict interpretation of the letter of the law, but on the fact of what was sufficient in the case to give a title by prescription. We can never forget that the British nation gave large compensation on the abolition of colonial slavery.

This moral claim to compensation, which in time of peace, owing to the cost, is in practice one of the greatest obstacles in the way of any kind of reform, by a curious perversion of the moral judgment has been put forward in war-time as the best means of facilitating drastic temperance legislation. The Government can only move, it is said, if there is general agreement, and this general agreement is to be found in the principle of liberal compensation. Those who opposed compensation to the liquor interests in time of peace (except in the way of self-supporting insurance) are urged to drop their opposition so as to take advantage of the moral force engendered by the war in favour of this more drastic control. Legislation which could not be carried in peace may be carried in war—if only adequate or liberal compensation is given.

On the other side, the liquor interests are told that now is their only chance of getting rid of a wasting security at more than the true market value, that is to say, having regard to this wastage. They are warned that temperance is growing by natural causes, *e.g.*, the preference of other pleasures to that of drink, the higher standard of morality and of fashion, etc.; they are warned that if they wait too long the eventual compensation that they will receive may be next to nothing. Therefore, let them cast their burdens on the Government, and convert their unearned decrement into a satisfactory increment.

But why should the State be called upon to add to the numerous financial responsibilities of the war an expenditure on social reform that would not be faced in time of peace? The truth is that so much has been said of the inexhaustible resources of British credit, and subsidiary war expenditure has been conducted with so loose a hand, that the people of this country have come to look on the war fund as a kind of wages-and-profit fund, and by the pernicious principle of equality everyone is supposed to have a dip. The whole nation has become infected with the spirit of extravagance, and the latest example is the temperance reformer. Where does he suppose that the money is to come from to pay this liberal compensation?

Not only is the war fund of the State supposed to be inexhaustible, but so also is its work fund. It is supposed to have at its command legions of officials and sub-officials. Out of this abundance of talent it is assumed that an army of valuators and legal interpreters and disinterested cork-screws could easily be found (at a price) for any scheme of compensated prohibition or nationalised management. The only thing forgotten is that the responsible Government with its higher officials is already over-burdened with the war, and an army of social reformers like the real thing requires control from above.

Such in brief is the growth of the snowball of compulsory temperance. The drinking excesses of a small minority call for some restraint. Equality says:—If one is restrained all

must be restrained. Property comes in and claims universal compensation, and British credit is called on to provide all the snow required out of the surpluses of its cold storage.

Is that all, it may be asked? Is no advantage to be taken of the moral uplifting of the war? The answer is the answer given by the King. Is not the appeal to every man's conscience in a time of national affliction of more value than any degree of compulsion? The method is as simple as that of Columbus with the egg, and the King himself has shown the way.

CHAPTER XVIII

THE DRINK PROPOSALS OF THE GOVERNMENT

(*March* 12, 1915)

As was anticipated, the ship that bore the fortunes of prohibition has been wrecked on the rocks of compensation. The result is, on balance, a good thing for the country. The middle of a great war is not a time for extravagant expenditure on social reforms. If social reforms are necessary they should be achieved by ruder and simpler methods, but in general they must wait for a more convenient season. Temperance is always good, and it is to be regretted that the efforts of temperance reformers were diverted from the paths of persuasion to the paths of compulsion. "Abstinence," says the Parson in the Canterbury Tales, "is litel worth, but-if a man have good wil ther-to." The attempt to use the occasion of the war in favour of extreme measures has been followed by a natural reaction. The mere rumour of general prohibition as possible was at once followed by the laying in of stores of liquor against the evil day. When the idea of prohibition was replaced by the more practical dread of heavy taxation the rush to lay in stores was intensified. Deplorable it may be—but could anything show more clearly how little in accord with public opinion were these drastic proposals?

But although the extreme form of prohibition has been wrecked, the ideas on which it was based still survive. The Government are not content to apply a definite remedy to a definite evil. They still search for a remedy that shall at the same time cure another indefinite evil. The definite evil is the slackness in the industrial provision for the war. The speech of Mr. Lloyd George, after all possible allowance

for over-colouring, showed that the evil demands a prompt and effective remedy. Figures were given and opinions quoted from persons in authority, which proved, so far as samples can prove, that the output of war materials and the provision of the subsidiary services of transport and the like were not in proportion to the military activity. Munitions were needed even more than men. The Navy itself, which is the very foundation of our national safety, had to wait on account of industrial slackness. Some men, no doubt, were working too much for real efficiency, but the averages of hours quoted were in many cases even less than in peace. At the front there was through the winter unexampled endurance and hardship—at home there was growing comfort and relaxation. Now we are told that very soon a supreme effort is to be made, and that the success is contingent on the work done at home. And yet the work is not being done as it should be. The position is such that it cannot be too often or too emphatically presented to the nation. The Chancellor of the Exchequer did well to make it the main burden of his speech of last week. The speech has been confirmed by the publication of the "White Paper."

But though the evil was most forcibly emphasised, the attention was diverted in the remedies proposed to something altogether different. The opportunity was used for the introduction of a scheme of penal taxation, which in some way was supposed to be involved in the specific proposals for partial prohibition. The consequence is that the public energies and the energies of the Press were mainly devoted to consideration of the inequities of the proposed taxation, and the real evil was again lost sight of.

In the practice of politics, as in the practice of physic, if you want to cure a disease you must first find out the nature of the disease and its cause. The nature of the disease that endangers the national safety is industrial slackness. That is admitted. The "White Paper" is an official report on "Bad Time kept in Shipbuilding, Munition, and Transport Areas." Different causes have been named

—*e.g.*, over-fatigue through bad adjustment of the working hours; the inferior quality of the men, many of the better kinds being at the front, etc. But the cause that was most insisted on by the Chancellor of the Exchequer was excessive drinking. The fatigue itself he ascribed largely to drink; and the inferior quality of the workers was said to make them inferior also in standing the effects of over-indulgence. The conclusion was that the proximate cause of the disease was drink. In mitigation of the moral indictment implied against large classes of the people, it was again stated with emphasis that the drinkers and slackers were only a minority, but they sufficed, and more than sufficed, to lower the whole productive power.

The next point was to find out the cause of this outburst of drinking, which, after all allowances, seems to be greater than in times of peace. Here the answer given by the Chancellor is most instructive. It is the high wages. The workers had much more to spend, and they spent it on drink. It is a pity he did not carry the search for causes a little further. What is the cause of the high wages. One answer is extravagant Governmental expenditure with a general inflation of prices. This is not the occasion for pressing this point. But apart from questions of currency and credit, which are the most difficult in the whole range of economics, it ought to be evident from the most general considerations that something is fundamentally wrong with our expenditure on the war.

On the outbreak of the war the Prime Minister, in most impressive speeches, implored the people of all classes to reduce their consumption, and in particular to eat less and drink less than usual. He recognised that war must mean a great destruction of wealth, that there must be less produced, and a lessened flow of consumable things. Apparently the idea has not been realised. On the contrary, we know that the imports into the country have reached a record surpassing the records of peace, and other signs show that the consuming power of the people has apparently increased. How is this Samson's riddle to be answered?

How can a devouring war be a cause of plenty? How can meat come out of the eater? The answer is that the nation is spending borrowed money at the rate of over a million pounds a day—probably by this time nearly two millions. That something is wrong ought to be obvious from the universal demand for a war bonus. Instead of people having to check their consumption to meet war taxes, they seem to think they have a natural right to an increase of wages on account of the war.

Nothing is more easy than for a nation or an individual to run into debt, and spend the money whilst running. Nothing is more easy than the preliminary stages of national inflation. But, on the other hand, nothing is more difficult than retracing the steps and checking the expenditure or contracting the inflation. This last week saw the Chancellor of the Exchequer adding almost another full million to his "emergency" Treasury notes. Prices are still rising, and likely to rise, and probably more devices and excuses will be found for more inflation before any real contraction takes place.

The disciplinary proposals of the Government have the merit of local treatment, and do not err on the side of mildness. But it is doubtful if local prohibition will restrain the real offender. It is true that the right to do ill deeds often makes the ill deeds done, and the open door is a better policy for Chinese trade than for the British public-house. But the prohibited areas are not likely to be surrounded by a hedge of preventive officials, and the drink urgently required for drunkenness will no doubt be imported in sufficient quantities for the purpose.

It is always said that it is easy to criticise; that something must be done; and that a critic should suggest an alternative. If provision of munitions and other war requirements is as much part of the real business of war as is the actual fighting, then it stands to reason that some kind of military discipline suitable to the case ought to be enforced. Let the interference with personal liberty and the habits of

peace be the minimum necessary, but let it also be not less than that irreducible minimum. Instead of penal taxation on the drink, put penal taxation or penal restraint on the slacker. In all industries bearing on the war regularity of work and efficiency ought to be implied or expressed as an essential part of the wage contract. If an offender pleads fatigue or illness, or other reasonable cause for absence, let the evidence be satisfactory or the penalties severe. If that does not suffice, let him be dismissed. It is absurd to speak of a shortage of labour such that you must employ labour not up to the standard required. The losses on the military side in the war do not prevent the war from being carried on, although amongst the losses are some of the finest men of the country. Cannot the industrial side of the business afford to lose some of the worst men? The offenders, we are told repeatedly, are a small minority. Surely the majority might well approve of measures that would keep the minority up to the proper standard. The minority might themselves approve of such compulsion, if their opinion could be got at in a sober or reflective moment. It came out in one of the inquiries on the Clyde that the men who most approved of total prohibition were the very class who were the worst of sinners. The celebrated anonymous drinker who wrote the open letter to Mr. Lloyd George approved of prohibition.

The most drunken firemen on the poorest of tramp steamers have not the liberty of drink on the voyage, and the discipline in peace on all ships is more severe than is required for ordinary industries in war-time. If we look into the real meaning of all wage contracts, the employer bargains for a certain amount of work under normal conditions in a normal time. If a man makes himself incapable of this normal work he fails in his duty, and in many cases is liable to criminal proceedings. In the transport services both by sea and land some kind of industrial discipline is enforced; so it is in mining and in agriculture. What would be the punishment of the more skilled farm workers who have to do with animals if through drunkenness they

imperilled the lives of the cattle or horses? And are not the lives of our soldiers of infinitely more importance? Let us not be deceived by words. Conscription, industrial as well as military, is to be preferred to the selfish liberty that endangers the whole State.

CHAPTER XIX

THE NEUTRALITY OF THE UNITED STATES

I.—The Immediate Interests

(*June* 9, 1915)

On the outbreak of the war the immediate interests of the United States seemed to admit of no doubt. These interests would clearly be best promoted by the maintenance of strict neutrality.

It has always been the policy of the United States not to interfere in European quarrels. Similarly the principle of non-intervention in the internal affairs of any independent foreign State has always been strictly interpreted, as is shown in the long-suffering of the anarchy of Mexico. A very practical proof of the reality of this policy of non-interference is found in the persistent neglect of military preparation. There is no provision for an expeditionary force, and without such a force the power of the Navy is limited.

The composite character of the people of the United States clenched the idea of neutrality with a very practical reason. By the last census (1910) it appears that the white population of foreign stock (*i.e.*, foreign born or one or both parents foreign born) is over thirty-two millions. Of this foreign stock about one-third—(say) eleven millions—is from Germany and Austria-Hungary, and about one-third is from the British Isles and Canada. The German element is strong in wealth and political influence, and to judge by the samples of its journals in sentiment is more Kaiserlich than the Kaiser.

Besides those connected by blood relationship with the different belligerent nations, there are many also closely con-

nected by commercial and financial ties. Some of these hyphenated financial interests are amongst the most important of the United States.

It was obvious at once that the war would involve immense monetary losses to the nations actively concerned. Their trade would be crippled and their capital replaced by debt. The United States, on the other hand, as a neutral, would be likely to enjoy exceptional gains, as a buyer of bankrupt stocks and a seller of the prime necessaries of life and of war at famine prices. In recent years the foreign trade of the United States has become of increasing importance, and the war promised openings for the capture of markets which the Germans had already taken from the British. As a result of the general financial disorganisation, New York might hope, if neutrality were strictly preserved, to take the place of London as the clearing house of the world. There is a glamour about foreign trade and the control of international money markets that appeals to the popular imagination in much the same way as the barbaric pearl and gold of the gorgeous East used to appeal to our ancestors. "The United States the Greatest Trading Nation," "New York the World's Banker," would no doubt be most pleasing headlines.

From the moral point of view the case for neutrality seemed equally clear. To the average American war is horrible. The doctrines of Bernhardi are repulsive; a retrogression to barbarism and not an advance to a higher plane. This disgust with Bernhardi's praise of war and the military virtues is so strong that Mr. von Mach, a German-American who has written an able presentation of the German case for the use of Americans, has taken pains in his introduction to repudiate Bernhardi. "It will hardly be doubted that Bernhardi neither spoke for the Germans as such, nor that his book had any influence on the people as a whole." Unfortunately, since the outbreak of the war, Bernhardi has been surpassed in violence in an enormous mass of German war literature—in journals, pamphlets, and books—and "military culture" must be taken to be, for the present at any rate, the ideal of the "Germans as such."

The actual progress of the present war has certainly confirmed the average American in his original opinion that war is horrible. War may be the lesser of evils; war may promote some of the highest forms of self-sacrifice and duty; war may foster some of the noblest virtues; these truths the Americans learned in their own Civil War, which is still a living memory; but they learned also that war is horrible.

Such being the state of affairs and of opinions in the United States, it was plainly the duty of the President to declare a policy of neutrality, and to endeavour to follow out this policy with the utmost strictness and good faith.

But although the immediate interests of the United States pointed clearly to neutrality, the war had hardly begun when the rule of neutrality presented difficulties of interpretation. Neutrality itself incurs obligations, and also claims rights. The United States, as the greatest of neutrals, is concerned to maintain a strict interpretation both of the rights and the obligations. This attitude is the natural counterpart of the policy of non-intervention. The position of the United States as a great pacific and non-interventionist nation would be intolerable if the military nations presumed to take advantage of this pacifism in their own interests.

So important is this championship of neutrality that it may be said to form an essential part of the national interests of the United States.

But the position of champion neutral thus assumed though obviously just in principle is beset with the gravest difficulties in practice.

It is to the interest of the United States—in the strictest interpretation of interest—that the accepted rules of international law should be observed by the belligerents and thereby the system of international law itself strengthened and consolidated.

For unfortunately what is called international law is in strictness only international morality. Suppose some powerful nation changes its view on the accepted moral law, what is to be done? Who is to decide if the change of view

is justified by the plea of national safety or military exigency? Who is to inflict the penalty, if any?

It cannot be expected that the United States (without an army) should rush in to separate the combatants and enforce the rules of fair fighting or the observance of treaties and agreements which cannot be considered as directly affecting American interests in the more narrow sense of the term. In some part of the world there is always being committed some crime against international law, but the United States cannot set up to be the general judge and policeman for the whole world. Don Quixote himself might have quailed before such a task.

Nor can the interference of the United States be determined simply by the magnitude of the offence or the estimate of its moral turpitude.

"It will never be possible in any war to commit a clearer breach of international morality than that committed by Germany in the invasion of Belgium." In these words ex-President Roosevelt has expressed the opinion of the civilised world. But it is by no means clear from the indignant sermon preached from this text that even he would think the devastation of Belgium in itself made the military intervention of the United States inevitable.

It is to be hoped that one result of the present war will be to stop such misconduct for the future; but such, alas! was also the pious hope of the latest Hague Conferences. The world still waits for the greatest discovery in practical morality—namely, the imposition of effective penalties for the breach of international law—effective, that is to say, as preventive.

In the meantime, however, even the champion nation of neutrality and of international law cannot be expected to go to war simply to enforce international morality in general.

But the case is at once altered as soon as any infringement of accepted international law affects not only third parties, but the United States itself. Under present conditions the only way in which international law can be maintained and

advanced is if every particular nation, so far as lies in its power, defends its own interests against any breach.

Belgium set an example that ought to be an everlasting landmark in the advancement of international law. For the present it is the worst case on record of the violation of that law. Belgium was offered the German guarantee of integrity and compensation for disturbance after the war if only she would permit the passage of German troops. A refusal was to be met by war. Belgium would not accept this interference with her political independence. Yet Germany had promised that Belgium should suffer no material injury if she yielded. Belgium has suffered martyrdom for a word—for an idea—the idea of political independence. The martyrdom of Belgium will be wasted unless as a consequence the law of nations is put on a more solid foundation, and unless a recurrence of such violation is prevented. In the meantime it is more than ever necessary that no further violation of accepted law should be suffered by the other neutral nations. It follows that the champion of neutrality ought to guard with the utmost jealousy any interference with its own interests as determined by international law. Any sacrifice of political independence at the present juncture is so far a reversion to barbarism.

It is, of course, a matter for the United States to determine how far in fact or in law there is a violation of its interests, and to judge of the inadequacy of any explanation or redress that may be offered.

It is worth while, however, to consider, by way of illustration of the general argument, what is meant by the interests of the United States apart from the general sympathy with law and humanity. We may begin with the lowest interests, that is to say, the lowest in the moral scale that is still commonly adopted by the nations—namely, the commercial interests. The commerce of the United States is carried on under the accepted rules of international law. The mere announcement through the usual diplomatic channels by some other nation of its intention to break this law makes no difference whatever to the rights of the United States. The

offending nation may plead self-defence or military necessity, but the very object of international law is to restrain the self-interest of nations. If the intention to break the law is not conveyed through the usual diplomatic channels, where it might well be checked in transit, but is only advertised in the newspapers, the offence is much aggravated.

When the breach of the law is specially aimed against shipping it reaches the highest point of audacity. A ship is thought to be as inviolable as a citizen; in all languages a ship is spoken of as a living thing, and to sink a ship unlawfully is, so to speak, murder, or culpable homicide, as the case may be. Some of the greatest wars have arisen in connection with the rights of shipping and the freedom of the seas.

If, however, the rights of trade and of certain kinds of property are regarded as of so much importance, *à fortiori* any offence against international law involving the lives of the citizens cannot be passed over without a sacrifice of the fundamental idea of political independence. The case of the *Lusitania* is very different from that of Belgium so far as it affects the interests of the United States. The horror of Belgium was greater, but it was not the property or lives of American citizens that were threatened. Although the *Lusitania* was a British ship and alleged to carry contraband, its destruction against the rules of international law, with the consequent loss of American lives, is an infringement of that elementary security that is the foundation of political society.

On the right of the United States to demand explanation and redress there can be no question, as was made perfectly clear in the first Presidential Note.

But in the matter of peace and war, the question of right is not everything; there is also the question of expediency. The distinction was admirably put by Canning in a speech on the Spanish question (1823). "Any question of war involves not only a question of right, not only a question of justice, but also a question of expediency. Before any Government goes to war it ought to be convinced not only that it has just cause for war, but that there is something

which renders war its duty; a duty compounded of two considerations—the first what the country may owe to others; the second what she owes to herself."

The primary duty of the United States to other nations, if the foregoing argument is accepted, is to insist that so far as she is concerned, no violation of international law will be permitted. The champion of neutrality must at least defend the rights of neutrals in its own case.

The duty of the United States to herself must depend on the view that is taken of her own interests. As already shown, the immediate interests are in neutrality, but unless the policy of a country is to be governed merely by the opportunism of the moment, regard must be paid to ulterior interests, and to the great principles which are at the basis of the constitution and life of the State.

The people of the United States are not governed simply by monetary calculations. Fifty years ago they submitted not merely to war, but to civil war of the most dreadful kind. What for? To determine the meaning of the word liberty. The liberty of the North fought against the liberty of the South—the higher liberty against the lower. Who could formulate in terms of money the points at issue?

And at the present crisis in the history of the world the duty of the United States to herself cannot be estimated simply in the effects on opulence, and still less by that part of opulence that arises from foreign trade and dealing in money. It may well turn out that this wider view of interests may show that the duty to self and the duty to other nations coincide to a great extent, and may involve a reconsideration of the policy of passive acceptance of the great German Revolution.*

* These two papers on the Neutrality of the United States were subsequently incorporated in a pamphlet under that title (Macmillan & Co., 1916). As foreseen, the United States eventually declared war on Germany on moral grounds.

CHAPTER XX

THE NEUTRALITY OF THE UNITED STATES

II.—The Ulterior Interests

(*June* 12, 1915)

At the outbreak of the war it was commonly believed in this country that the German nation had been led away by the Emperor, and the Emperor by a military clique. The English-speaking races take it as an axiom that you cannot bring an indictment against a nation. Most people in Britain believed that as soon as the Emperor had been found out, and even if victory was delayed beyond the appointed day, there would be in Germany revolution and disruption.

The course of the war and the publication in Germany of masses of war literature have shown that these ideas were the reverse of the truth. The Emperor is the best-beloved man in Germany because he best represents the national ideals.

"It is no longer possible," says Mr. von Mach, "to speak of a clique as in command of the Government. The communal and individual life of Germany is democratic, and the heads of departments are drawn from all classes." The Emperor is well spoken of at home, and is beloved by his people, "not because he is autocratic, but because his aims throughout his reign have been the aims of the healthy pulsating life of Germany—peace and progress." The Germanic ideas of peace and progress have received very full illumination, not only from the war literature, but from the war practice. The kind of peace is certainly the kind that promotes progress; but the progress that is sought after is the progress of the German Empire regardless of

the rights of other nations. It is not the German Emperor only who wants a place in the sun and is not satisfied with peaceful penetration. The whole nation has been seized with the lust for military dominion.

In the same way it is not only by the military caste that war has been glorified. The whole nation has been taught to believe that the virtues of war are nobler than the virtues of peace. The hatred of England is not due simply to her unexpected intervention in the war, but to the feeling that English ideas are most opposed to "military culture." A book has been published recently by W. Sombart, one of the best known German Professors of Political Economy, under the title of "Traders and Heroes." The main point of the argument is that the present war is a struggle between "the shopkeeper" and "the hero"; between the mercenary and the heroic spirit. England is the nation of shopkeepers and Germany is the nation of heroes. Not only is war glorified, but military necessity or advantage is made the final test of justice. "War is war" is not merely the excuse of the ruthless soldier, but is accepted by practically all the leaders of thought in Germany as a sufficient excuse for the sufferings of Belgium; it is a pity that in war the innocent must suffer with the guilty—that is all.

It is only with the greatest reluctance that the British people have been forced to the conclusion by overwhelming evidence that the German nation is throughout permeated with these ideas of "military culture" and of the morality of might.

It is an old saying that England is "a nation of shopkeepers." The expression was used by Adam Smith, and is, at any rate, good enough to be opposed to "the nation of heroes." But, whatever words of praise or dispraise are employed, there can be no question that the ideas at the basis of German military culture and hero worship are exactly the opposite of the great ideas under which the British Empire has grown up and been extended over so wide an area.

And the key to the present argument is that it is precisely

these same ideas which have dominated the growth of the United States, and with the vigour natural to a young nation unfettered by ancient history and with boundless territory have been pushed farther than in the old country.

If the opposition between the German and the British ideals is marked, the opposition is still stronger between German ideals and the ideals of the United States.

What, then, are these great ideas which dominate British civilisation, and are still stronger, because less restricted in their unfolding, in the United States? What are these great ideas which are so opposed to the ideas of the German Revolution?

The most persistent and forceful of them all is liberty. Liberty must always mean liberty under the law, but in the British and the American nations the ideal is a maximum of freedom with a minimum of coercion and regulation. In Germany, on the other hand, the idea has been fostered that State regulation is better than private judgment, and that obedience is better than liberty. In the English-speaking nations the great principle of equality before the law is carried out to the full extent. With them the law is no respecter of persons. In Germany, even in peace, ideas of military privilege offend against this principle, and in war military privilege is supreme.

As regards constitutional liberties, there is very little difference between the United Kingdom and the United States, although in names and in theory the latter is ostensibly the more advanced. The retention of the hereditary principle in the British Empire is rather a formal than a material difference.

In the German Empire, on the other hand, the Emperor is not, in the British sense of the term, a constitutional monarch. His personal power is real and great, alike in the choice of Ministers, in the determination of foreign policy, and in the conduct of war. How the German people can submit to a non-constitutional Government is always one of the wonders of the world to the British mind. The present German Emperor believes in his divine right. The

last King of England who believed in his divine right was executed more than two and a half centuries ago.

In the German system of local government the permanent State official holds a dominant position. The Government expert is everywhere. In this country, on the other hand, as Mr. Dawson observes in his great work on "Municipal Life and Government in Germany," "most Englishmen at heart prefer the worst of amateurs to the best of experts, and would rather be wrong with the one than right with the other." But this greater German efficiency is bought at the cost of a depression of individual character and of the essentials of liberty that are the life and soul of the English-speaking nations. In time of war this acquired docility of the German has its advantages, at least in its earlier stages. It has its advantages in regulating the consumption of food and the provision of military requisites. But the point is not as to which system gives the best military results for the time being, but whether British freedom or German obedience is most in accord with American ideals.

In comparing "the shopkeeper" with "the hero," the most striking and obvious difference is in the provision for military requirements. The British ideal is to use the minimum of military power that is necessary to support the defence of the Empire. The Germanic ideal is to organise the Empire in such a way as to promote the highest military power possible. It is not necessary to point out that in the United States the non-military ideal has been carried to an extreme. Even the United States, however, in recent years has found it desirable to keep up an effective Navy. In the British Empire the proximity of the British Isles to Europe and the vast extent of the British dominions make a strong Navy a necessity. But relatively to our national obligations when the present war broke out, we were only possessed of the minimum military power requisite for our defence. Mr. von Mach, in his chapter on "Militarism," tries to show that militarism prevails to a greater extent in the United Kingdom than in Germany. This extra-

ordinary paradox is supported by taking the amount of money spent by the United Kingdom on the Army and Navy per head of population, and comparing the amount per head of Germany. "Figured per capita," he says, "the United Kingdom in 1911 was spending about 60 per cent. more than Germany." Therefore, apparently the United Kingdom is afflicted with militarism more than half as much again as Germany.

Unfortunately for this conclusion, it is forgotten that the population of the United Kingdom is only about one-tenth of the population of the British Empire, and the main burden of the defence of the Empire is thrown on Britain.

In British policy the principle of non-interference with the internal affairs of foreign States has long been the accepted rule, and in the United States the rule has again been carried to an extreme.

With Germany, on the other hand, the degree of interference appears to be only limited by the chance of success.

With regard to external relations with foreign countries, the present war has shown that, whilst Britain made the observance of treaty obligations the first consideration, Germany began by an official repudiation of international law. "We have been forced into a state of self-defence, and the necessity of self-defence knows no other law. Our troops have occupied Luxembourg, and have perhaps already been obliged to enter Belgian territory. That is against the rules of international law." Thus spake the German Chancellor, and the appalling devastation of Belgium has made his words immortal. A belated attempt was made to explain away the speech, but the explanation was more than neutralised by a series of other violations of international law, culminating (for the time) in the sinking of the *Lusitania*.

Only on one other point need the comparison of national ideals be extended. One of the great ideas common to British and American policy is the idea of humanity. The evidence is overwhelming that in the conduct of the present

war Germany has transgressed the moral laws of humanity to an incredible extent.

Such, in brief outline, are the chief features of the British and of the German ideas of government as compared and contrasted with those of the United States. To the impartial observer in the United States we may say :—Look on this picture and on that, and see, which is most like your own country—which answers best to the ideals by which your national policy is guided ? On which side will you throw the weight of your moral approval ?

The impartial observer may, perhaps, hesitate, and say that the choice between ideals of Empire is none of his business. The United States, as a nation, he may urge, is not only non-military but non-imperial. The American Republican does not like the word empire, even when it is joined with the word liberty.

But if he does not like the idea of empire with liberty, how would he like the idea of empire without liberty ? The ideal of government in the British Empire, as in the Motherland, is the maximum of liberty that is consistent with the development of each part and the security of the whole. This ideal had been realised in practice to an extraordinary degree, as was shown in a marvellous manner on the outbreak of the war. What Germany had expected and hoped for and paid for, was an outburst of rebellions against the British yoke, and a rush to the friendship and protection of Germany. In the words of the great adopted poet of Germany, the subject races of Britain were to say—"Now is the winter of our discontent made glorious summer by this sun of—— !" What is the missing word ? Who except a Prussian would venture to say—Prussia ?

The latest German suggestion is that the United States has more to fear from the Marinismus of England than from the Militarismus of Germany. For a hundred years past the United States has had nothing to complain of from British naval power ; what Germany means by the freedom of the seas may be conjectured from the use of her submarines. If by any disaster the outcome of the present war were

altogether favourable to Germany, and if to the military power of Germany were added the power of the sea, the world dominion of Germany would be unquestioned for many generations.

That is the real issue of the war. Could the United States contemplate with equanimity such an accession of power by Germany? Could the United States afford to see the British Empire go under, and a German Empire on even a larger scale take its place?

What are the real ulterior interests of the United States in this world struggle? Surely the interests that are most in accord with the national sympathies and ideals: liberty, justice, and humanity. In this sense it is not the chief interest of the United States to pocket the money gains of neutrality from the expansion of foreign trade. It is not her chief interest to see in her own territories the greatest number of people producing and consuming the greatest amount of material wealth, regardless of the rest of the world. Non-intervention may be good, non-militarism may be good—but the United States cannot live in isolation. And it is not to the interest of the United States that international law, which has grown up with the growth of civilisation, should be uprooted by military force, and that the ideals of Western freedom should be displaced by the ideals of German discipline.

By all means, if possible, let the United States avoid war—by all means possible unless war becomes her duty—"a duty," again to recall the words in which Canning expressed the general moral judgment nearly a hundred years ago—"a duty compounded of two considerations—the first what the country may owe to others; the second what she owes to herself."

What she owes to herself it is for herself alone to decide. What she owes to others is to support, so far as her duty to herself will permit, the law of nations as against the arbitrary violation by military power.

CHAPTER XXI

THE NEW WAR LOAN AND ECONOMY

(*July* 10, 1915)

THE occasion of the new War Loan has been seized by the Prime Minister and the Chancellor of the Exchequer and the Bishop of London and so on in a descending order of dignity by all sorts of people to preach economy in eating and drinking of the most old-fashioned order. It really seems as if gluttony both of the quantitative and of the qualitative kind were once more to be reckoned amongst the sins and not amongst the virtues. Already public dinners and private dinner parties are almost unfashionable; and the papers are full of calculations of the number or the weight of the proteids or other meaty elements necessary to support life. The vegetarian is no more an example to be wondered at, but one to be followed. Persons of importance write to the Press to suggest that the flower beds in the parks should be planted with summer cabbages, to be followed by a course of winter parsnips, and so on of other devices in a descending order of usefulness.

We might be a little more confident that some good would come out of the preaching if we did not remember that about three months ago the preachers and the country were in a still greater ferment about the drink than they are in now about the victuals. The net result has been (it is hoped) an improvement in the quality of the spirits, so that people can drink as much as before, but with less danger to their equilibrium or their longevity. That is about all that remains of the great outcry in favour of universal prohibition, coupled with universal compensation.

It is easy to show by a little bit of moral arithmetic that if

we drink 160 millions a year, and if of this (say) only twenty-five millions a year is medically necessary, we waste the interest on a loan of 3,000 millions at $4\frac{1}{2}$ per cent.

But the well-known characteristic of figures in mass is that they have little effect on the conduct of the individual. The eternal difficulty of preaching morality wholesale is that each particular unit thinks his own little lapse or effort, as the case may be, can have no effect on the total mass. A drop in the bucket or a drop out of the bucket—what difference can it make to the bucket? That is the vital difficulty in the best-laid schemes for Socialism or war loans that depend on the appeal to the public spirit of individuals. And this explains the parodox that a man will give up his life by voluntary enlistment, but his brother at home will not give up his glass. The man who gives up his life knows it is something; the man who does not give up his glass thinks it is nothing.

Is, then, no appeal to be made to the individual to check his consumption in the national interest? By all means; but let the appeal be such as to enter into his heart and mind. The ordinary person cannot see the connection between saving a crust of bread or a lump of sugar and helping a war loan of 1,000 millions.

The provision for contributions in small sums by the issue of the five shilling voucher and the five pound bond will probably do more for the War Loan than appeals for lessened eating and drinking. Most people, and especially the wage-earners, are used to making money contributions in small sums for big objects, and they can understand, even for a war loan, the usefulness of small money contributions. At the same time, when the War Loan is presented to them as a business proposition, they are entitled, as much as the big financiers, to look at the business side closely. Instead of appealing to their patriotism, which is unnecessary, it would be better to try to get over their difficulty. The difficulty with the small investor is that the War Loan is excellent as a permanent investment, but suppose the investor wants to get the use of the money for some pressing need. He is told

he can sell out at the market price of the day, and it should be clearly explained to him what that means.

But if it happens that the market price of the day is below the subscription price, the little capital is so far eaten into.

From this point of view it is quite irrelevant to speak of the security of the British Government. The War Loan of last year has fallen quite 2 per cent. (if we reckon accrued interest), and the old Consols are practically unsaleable at the official price, 35 below par. The interest covenanted for is no doubt quite secure—so far the guarantee of the British Government is perfect—but the capital value becomes less with every rise in the outside rate of interest. Nothing is to be gained by making a confusion between two different kinds of investment. All banking rests on the recognition of the difference. If people wish to save money, and also to have the money at call whenever they wish, they must be content with a low rate of interest, or sometimes none at all. The people who use savings banks, and have this privilege, are very well off with the interest they receive. If, on the other hand, people want a permanent investment, or mean to let the money lie; it may be, for years, nothing could be better than the new War Loan. Of course, it is possible that the stock may rise instead of falling in price when the war is over, but it is extremely improbable that there will be any rise in price before the end of the war. It is much more likely that there may be some fall until a higher rate of interest has to be paid on the next loan, and then the price will rise again, and the higher rate will also be obtained on the old investment.

It would be a national misfortune if small people are induced to put their savings into the War Loan under the idea that they can at any time draw out the money intact with the accrued interest. The War Loan is an excellent investment for the small person, but the market price will be subject to variation, and should be allowed for.

The appeal by people in authority to check consumption is not only of a general character, but of a very special

character. People are exhorted to be sparing in all things, but most of all in imported things. Whatever you do—that is the text—consume the home-made and not the foreign-made in your eating and drinking and apparel and everything on which you spend your money. All the old wisdom about buying in the cheapest market has gone the way of Jonah. Just as we have got back to mediæval morality about gluttony and the like, so we have got back to mediæval ideas on foreign trade. The mediæval man believed that the country would lose if it exported good wool—wool the like of which no country could raise—and got in return "apes and japes" and other luxuries. Therefore, said the mediæval man, live on your own and let the foreign luxuries go by.

But this was only part of the old learning that we have gone back to. The old idea of foreign trade was that the advantage to the country was to be measured by the favourable balance. Therefore, it was said, check your imports as much as you can, and encourage your exports; because in this way you will get a balance of money due to the country. And the greater the balance the greater the advantage. This is the doctrine which a year ago was considered the height of folly. Of course circumstances alter cases, and the case of war and of a War Loan is a very different case from peace and the investment of surplus national savings in foreign parts. But, all the same, when people are invited to give up all they have been taught about the blessing of imports in ever-increasing abundance, they naturally want to know the reason for the sudden change. And thereupon the advisers of the people, from the Prime Minister and the Chancellor of the Exchequer downwards, do their best—and they do it very well—to explain to the people the theory and the practice of the foreign exchanges, with special reference to war and war loans.

The great difficulty, we are told, is the New York Exchange. A quotation which used to move about 4·87 has taken to moving about 4·78. That is the fact we start with; and it

seems absurd that a mountain should be born out of such a ridiculous little mouse. But so it is. The change in the order of these two figures (though they are only decimal point figures) is a change in the financial barometer from fair to rain, and if the English barometer is to follow the spasms of the French and the Russian barometers, then much rain will be too mild a description.

The readers who have skimmed the preceding paragraphs on foreign trade, and were giving up altogether at the New York Exchange, may now be invited to begin again. They may take it, on the authority of the Government, that the country is in an increasing difficulty in meeting its payments for foreign imports. In the last resort the balance that is not met by exports must be met by something else. All the gold in the banks is not enough. And long before all the gold is taken from the banks there would be something very like a crisis.

That is the real meaning of all the talk about the foreign exchanges. All our vaunted system of credit rests on a gold basis. The system is in perfect working order if all the forms of credit and all the monetary obligations are convertible into gold on demand whenever required. If there is any delay interposed, if there is any suspension of the convertibility, then the machine does not work well. In ordinary times very little gold is required, but even in ordinary times a large amount of gold is kept as a central reserve in the Bank of England. The proportion of that reserve to the immediate claims that may be made on the Bank is one of the signs of the soundness of the national banking system. Before the danger of war was realised and banking was in a normal state, the last return of the Bank of England (July 22, 1914) gave a proportion of reserve to liabilities of $52\frac{3}{8}$ per cent.; by the return last week the proportion was $16\frac{1}{8}$.

The reason for the fall is the continuous drain for foreign payments, and that accounts for the anxiety of our financial authorities for a more favourable balance of trade, and for these appeals to the public to check their use of imports

and of things that may be exported. The appeals and the advice are much more worthy of consideration as symptoms than as remedies.

The remedies will have to be much more severe than changes of diet and changes in relaxations. In what book on the foreign exchanges, from Goschen's downwards, will the reader find a mention of an appeal to the consumers of imports and exports to readjust their consumption so as to correct the foreign exchanges?

If the Government are really anxious to check imports of consumable commodities, there is one very simple and most effective remedy. That remedy is to lay on heavy taxes. Compulsion is in the air; compulsion is becoming the fashion. We are all of us (so we say) longing to be compelled to do something for the country. All we are afraid of is that we may happen to do more than our share, whilst other people are doing less. Our sense of justice will not admit of such inequality. Numbers of young men are burning to enlist, but their ardour is extinguished by the dread of injustice. Let compulsion come to all, and to all alike, and none will be more willing. That is the chorus.

In the same way, there are all the people who are too old or infirm or too young or too feminine to work at war things, and they are all longing to be compelled to do something. What they want above everything is compulsion, or at least a badge to show that they have been compelled and found wanting.

How much longer are the people to be left without the compulsion that will fall directly or indirectly on all the people? There is no compulsion like the compulsion of taxation—except death. Death and taxes none can escape, said the old proverb. This proverb is still true of death, but not of taxes, because in these days on balance a great mass of people escape taxation altogether. On balance, that is to say, after allowance is made for the public expenditure made on their behalf for things they formerly had to do for themselves.

Taxes have two main functions. The chief and original

function is to raise revenue. From this point of view, the best taxes are those which are most productive of revenue at the least cost and also satisfy the sense of justice. The present income tax is an excellent revenue-producer, but it is unjust in many ways.

The other function of taxation is preventive, and so far as taxes are preventive they cannot also at the same time obtain revenue from the people who do not use the taxed things. Of course, a very high tax may be prohibitive to some people, and make others pay a good deal to the revenue. If taxes are to be imposed on imports, these two ideas must be separated. Under present conditions, it seems as if the yield of revenue is of less importance than the check to consumption—that is to say, if we are to accept the position that it is the duty of everyone to consume as little as possible. Taxes of any kind whatever would check the consumption of somebody. They would also have the moral advantage of bringing home to the payers that there is a state of war, and that in war-time people ought not to expect that there should be no change whatever in the standard of comfort. To keep up consumption as usual and to raise as much as possible by debt, without resort to taxation, shows a very poor public spirit. It also encourages reckless extravagance in all kinds of public expenditure.

Preaching private economy is a very feeble remedy against the practice of public waste.

CHAPTER XXII

THE PERIL OF PUBLIC EXTRAVAGANCE

(*July* 24, 1915)

AT last, in the twelfth month of the war, an effort is being made by public speeches and leaflets to check the private extravagance even of the wage-earners. An appeal is made to them to invest some of their war bonuses in war vouchers that will yield 5 per cent. They are even implored to check the consumption of imported luxuries so as to steady the foreign exchanges—and the advice is likely to have about as much effect as the absence of the daily forecasts from the papers has on the steadiness of the weather. The preaching of personal thrift at the present juncture is no doubt to be highly commended, not only on economic but on moral grounds. The war ought to make a mighty appeal to the moral sense of every honest man. In a time of national danger a man who wastes his substance or his energies is wasting his own soul and helping to waste the soul of the nation.

But when all is said and done, the checks on private extravagance will be of little use unless checks are also imposed on public extravagance. Great nations, said Adam Smith, are seldom much affected by the extravagance of individuals, because the extravagance of some is in general compensated by the frugality of others. He even maintained (of course he was a Scotsman) that in the greater part of men, taking the whole course of life at an average, the principle of frugality seems not only to predominate, but to predominate very greatly. He admits, however, that "the principle of expense prevails in almost all men upon some occasions and in some men upon almost all occasions."

Unfortunately the present war seems to be one of the occasions in which almost all the people of the country are bitten with the microbe of extravagance.

But the main burden of Adam Smith's argument is that the real danger of the impoverishment of great nations lies not in the private prodigality of the people but in the public prodigality of the Government. The recent experience of this country seems to show that it is no exception to the general rule.

For some years before the war began our public expenditure was open to the charge of prodigality. The main figures in proof of this charge were brought out in a recent debate in the House of Lords, not, be it observed, in the House of Commons. In the House of Commons, a day or two later, the Prime Minister said with grim truth that the usual result of any discussion in the House of Commons of the Estimates was an increase in the amount. Even in peace time, with exuberant prosperity, debt was being piled up. It is true that nominally a certain amount of the old National Debt was being paid off, but permanent public charges of an unproductive character were incurred to a much greater extent—unproductive, that is to say, in any interpretation of the term productive expressible in real money valuations. We were told much about an increase of efficiency, but too often the fact took the form of an increase in bureaucracy. Does anyone really suppose that in Scotland the mass of the people are better educated for the ordinary business of life and the moral conduct of life in the palatial Board schools of the present than they were in the thatched cottages of the parish schools of the past? Even in peace the taxes which ought to have been reserved for an emergency were put on a war footing. The income tax was not only increased in the higher incomes, but taken off entirely in the lower incomes formerly included. The productivity of the tax for emergencies—its greatest merit in the eyes of Mr. Gladstone—was seriously injured at both ends. The same improvident policy was followed in the death duties and taxes on accumulations of capital.

At the same time, those indirect taxes which fall on the masses of the people were diminished whenever any occasion offered. The general result was that the people who received the benefits of the public expenditure were the people who paid the least in taxes and had the greatest voting power. This increase in public expenditure for social benefits was accompanied by a growing reliance on Governmental help in all sorts of things which the people before had done for themselves, with a consequent strengthening of the national character.

When the war broke out, instead of any check being placed on the spirit of extravagance and on the reliance on the State, exactly the opposite happened. For every little disturbance of the usual arrangements Government was called on to provide a remedy. And instead of the Governmental energies being concentrated on the conduct of the war, they were saddled with extra peace duties. Everyone asked for Governmental help, and nearly everyone got it.

It is one of the evil traditions of the British Government that Government must expect to pay higher than other people. In Germany the case is the opposite. In Sven Hedin's book on the "German Armies in the West," amidst the barren waste of his accounts of joy motor rides and suppers with "wee German lairdies" there are occasional bits of valuable information on German finance. The point is that German methods will take a good deal longer to come to their last hundred millions than will the British methods. On his way to the front, whilst in Germany Sven Hedin found that officers get what they require, and pay with a receipt. "On producing this receipt before the competent military authority, the host receives his money, but not at the same rate as in peace time, for values are set at a lower figure than under normal conditions. The same applies to horses, carts, motor cars, and much else that is needed in war. Everything is valued by special committees, and then paid for with a receipt." Needless to say that in the occupied enemy country the mode of payment is still less burdensome to the German higher command. The unfor-

tunate purveyors of war necessaries or luxuries are paid in *bons*, and the *bons*, they are told, will be met out of the indemnities to be got from the conquered, especially, it may be assumed, the British.

Apart from the usual causes of public extravagance—*e.g.*, the incompetency of routine officials to initiate and carry through great changes, the employment of men of war for trading, the wickedness of contractors and sub-contractors, and the other evils last illustrated in our last war—in this war there has been one special cause at work not usually associated with or expected in great wars—namely, a great and protracted inflation of credit.

The natural idea is that on the outbreak of a great war there will be a great collapse of credit, and that only very gradually will a recovery be made. Seeing that London was the clearing house of the world as regards credit transactions, and seeing also that this country is internally at a higher stage of credit development than any other country, it was inevitable that the Government should take measures to preserve the credit system of the country, both in its foreign and its internal arrangements.

This was a necessary part of the duty of the Government, because in the last resort it is the Government that prescribes and provides legal tender for the payment of debts. A limited moratorium and a limited issue (or power of issue) of emergency currency were natural remedies under the circumstances. It may be said that the moratorium and the emergency currency were forced on us by the action of other countries.

But although something had to be done, as the course of events has shown, the Government did far too much in its support of credit. It is not necessary to recall the various measures taken, but the result was that, instead of merely staving off a crisis, credit was extended so as to lead to a general inflation. In ordinary times any general inflation of credit after a certain point is checked by a very real limit—namely, the necessity of providing legal tender for cash transactions. An inflation of credit in general first

raises wholesale prices and profits, and is followed by a rise in retail prices and wages. The rise in these things means that more legal tender must be provided. In all countries in normal times the amount of gold currency available is never capable of much extension, and the amount of bank-notes and subsidiary currency is always proportioned with varying degrees of elasticity to the amount of gold in the banks. In the United Kingdom, under normal conditions, the amount of bank-notes that may be issued is much more stringently limited than in any other country.

This strictness as regards the creation of paper money has been no doubt one of the principal causes of the financial supremacy of London.

In an ordinary inflation of credit not only does the internal rise in prices lead to an internal demand for legal tender (that is for gold or currency based on gold), but it also leads to a demand for gold for export. The inflation that raises prices at home encourages imports into the country and so far checks exports. The balance of indebtedness turns against the country, and there arises what is called a foreign drain for gold. This drain may be so sudden and so large that at once it puts a stop to the inflation of credit. The central banks raise their charges, and they look more narrowly at the securities offered.

The so-called emergency measures taken by our Government at the outbreak of the war and continued since have removed these rigid limits on the inflation of credit. Any internal demand for legal tender to carry on trade and effect cash transactions at the higher level of prices has been met by issues of Treasury notes and silver.

In the course of these papers from the beginning attention was called to the dangers of the inflation of the currency. The first danger is a general rise in prices or a fall in the purchasing power of money. That such a rise of prices has taken place (whatever the causes) is known from official returns. The rise of prices, if it is to be kept up, requires the circulation of a larger amount of legal tender than was the case before the rise. More cash is needed for higher

wages and retail purchases, and so on. If the cash were not forthcoming, the prices could not be kept up.

The rise in prices has had serious consequences. One of them is the war bonus, perhaps the most astonishing fungus that ever afflicted a long-suffering nation in war-time. The worst of it is that a luxurious crop of war bonuses is looked on as a sign of national prosperity. On any proper interpretation it means that by way of providing for the enormous expenses of war the country is consuming far more and producing far less than in peace.

Another evil of the rise in prices is that all the expenses of the war are so much greater—where two millions a day might have sufficed (even with British wastefulness), another million is required to meet the rise in prices. The same thing applies to the accumulation of war debt. More money has to be raised, and is more quickly spent.

A general rise in prices is the natural consequence of an inflation of credit and currency. It may be too difficult a task to reverse the rise so far effected. A sudden contraction of the currency to its old limits is impossible, but at least any further inflation should be stopped. By the returns, however, of the last two weeks, the amount outstanding of the emergency Treasury notes has been increased by nearly three million pounds. Latterly the state of foreign indebtedness has begun to cause anxiety. Any considerable export of gold will bring rapidly nearer the definite adoption of inconvertible notes. The Government, by way of preparation, should issue one or more leaflets showing with notable historical examples, brought up to date by reference to the other belligerents, the nature and evils of inconvertible paper.

Apart from the inflation of the currency and the danger of drifting into inconvertible paper, there is to be considered the waste of public credit. The apparent success of the new War Loan is apt to lull people into a false security. The rate of interest found necessary to float the loan ought to be a warning. British credit at $4\frac{1}{2}$ per cent. seems incredible. But in order to attract new money privileges were

granted to the holders of old forms of public debt, which meant an additional charge to the Government. More than this, a promise was given that in any new loan (not external) at a higher rate of interest, the present loan would automatically get the benefit. In order to attract small subscribers special privileges were given, again involving extra cost, whilst in this case there is the further danger that on any depreciation of the market price of the stock the small investor will have to get a war bonus. The rise in the rate of interest is in itself bad enough. It means that so much more must be raised by taxes to pay the interest, and with all the present reluctance to adopt war taxes it is impossible not to pay new interest out of new taxes.

But the rise in the rate of interest (with the extra privileges) is of even more importance as a symptom of the approaching exhaustion of public credit. After the pæans on British credit at the beginning of the war, to speak of possible exhaustion may seem alarming. But the rate of expenditure has also been alarming. We are told that the war is now costing nearly four millions a day, and that the tide of expense is still rising. Is it never to be realised that every extra million of public credit wasted brings us nearer to the end of all credit, and to the subscription of forced loans and inconvertible notes and all the other horrors of financial debility? We are not yet in actual danger, but surely the time has come when the most severe restraints must be put on the public extravagance.

Before the war Germany was calculated to be about as wealthy as the United Kingdom. What is now the real state of German credit in spite of German organisation and authority? Are we to follow Germany on the road to ruin, or shall we make certain of success by solid economic endurance?

CHAPTER XXIII

THE DEPRECIATION OF THE POUND STERLING

(*October* 2, 1915)

In this series of papers attention has been called from the beginning to the dangers arising from the inflation of the currency and of credit. It was pointed out that such an inflation was likely to cause, first, a general rise of prices, and, secondly, an unfavourable rate of exchange in foreign payments. A general rise in prices means a fall in the purchasing power of the pound sterling, or technically a general depreciation as compared with commodities. The fall in the rate of exchange in foreign payments is the specific depreciation as specially shown in the relation of the pound sterling to the American dollar. Both kinds of depreciation are closely connected, and after a certain point is reached in inflation are certain to occur. As a rule, however, the depreciation of both kinds only sets in gradually, and when it is too marked to be passed over is usually set down to other causes. The consequence of this faulty diagnosis is that the inflation is allowed to grow, and the evils are met by temporary expedients which do not strike at the root cause.

The present monetary situation in this country illustrates the justice of these general observations. The recent reports of the Board of Trade and the records of the *Economist* index number show that since the beginning of the war the purchasing power of the pound sterling in this country has fallen by about one-third. The serious fall in the American exchange is obvious from the appointment of the Commission now touring the United States under the leadership of the Lord Chief Justice of England.

The facts of depreciation, both general and special, cannot be denied, but there is still a great reluctance to ascribe either one or both to the inflation of the currency. The inflation is not supposed to have even a partial influence, and it is allowed to continue at an increasing rate.

In the present paper the rise in prices only will be considered, or, in other words, the general depreciation of the pound sterling. This depreciation, whatever the causes may be, is productive of very serious difficulties. There is, for example, the great difficulty of readjusting wages to the new scale of prices. It is, of course, true that in a great war labour ought not to expect to bear none of the sacrifice, and to have no fall in its standard of comfort. But if there is a general rise of prices through inflation, unless wages also rise so far, there will be an exceptional gain for profit. Apparently labour is not unwilling to bear its share of the burden, but it is suspicious of the gains of capital. The only justification for general war bonuses to those above the poverty line is the recognition of such a general rise in price as may be caused by inflation. But from any point of view war bonuses must be set down as at best a choice of evils.

Although the connection between inflation and the rise of prices may be denied, the inflation itself must be admitted. Even those who most applauded the measures taken to support credit on the outbreak of the war now confess that the support was very much overdone. Little harm would have ensued if the measures taken had come to an end with the emergency from which they arose. But although the banking system of the country quickly recovered its normal working capacity, the so-called emergency measures were continued. The most important of these measures was not only continued, but greatly extended in the progress of the war—the measure, namely, which provided for the issue of Treasury notes for £1 and 10*s*. The reason at first assigned for the issue of these notes was that they were needed to take the place of other forms of bankers' credit. It was supposed that in the war crisis people might wish to

withdraw their deposits; that they would look askance at cheques; and that more transactions must be conducted on a cash basis. (The banks were to be allowed to obtain Treasury notes to the extent of 20 per cent. of their deposits, and if the privilege had been acted on the country would have been flooded with £200,000,000 of notes—which, as Euclid used to say, is absurd.) But when the emergency had been surmounted, with an immense display of jubilation on the part of all concerned, the emergency notes, instead of being withdrawn, were increased.

The facts regarding the issues are very striking. At the end of September, 1914, by which time the crisis had passed, the outstanding amount was just under twenty-eight millions. In the last three months of 1914 this amount had been increased by ten millions only. But in the one month from August 11 to September 8, 1915—*i.e.*, after more than a year of war—the outstanding amount was increased by more than twelve millions. In the next week ending September 15 over six millions more were added, and this last week ending September 22 another three millions has raised the aggregate outstanding to over seventy millions.

As the suppression of the crisis and the victory over the emergency had been celebrated nearly a year ago, it has become necessary to find a new justification for the continued increase in the issues. The theory now is that the notes are issued to take the place of gold in circulation. It is argued that the gold will be far more useful in a central bank or a war-chest than in the pockets of the people. The experience of Scotland is appealed to in the matter of the one pound notes, and long ago the half-sovereign was condemned as a most wasteful coin. These reasons are in themselves excellent. The pity is that they were not discovered sooner by the responsible authorities. If, after the immediate crisis of the outbreak of war had been got over, steps had been taken to withdraw the gold from circulation and to substitute notes, probably no objection would have been taken by anyone. There was a general feeling that gold was needed by the State. But not only was the gold allowed

to remain in circulation, but in the first year of the war from July 29, 1914, to July 28, 1915, the Bank of England was said to have lost in gold currency to the provinces about twenty-two millions. Under pressure from the Government on the banks part of this gold has been recovered recently, but by the latest reports it seems that the inflow from the country has been diminished or even reversed.

In addition to the Treasury notes there has been an increase in the issues of other banks, *e.g.*, the Scottish banks and the Bank of England, and there has also been a large increase in the silver coins.

The general conclusion is that if we compare the amount of money used for internal purposes before the war with the amount at present in use, there has been a very great increase. Such a great increase in the quantity of money in a country might be expected to raise general prices, and accordingly it is reasonable to ascribe at any rate part of the admitted rise of general prices in this country since the war to the inflation of the currency.

This view is confirmed by the weakness of the other causes assigned. Such causes, if they are adequate to account for a general rise in prices, must be of a general and wide-reaching character. When prices began to rise the cause usually assigned was scarcity of commodities. The official returns of imports and of the consumption of representative commodities show that scarcity can no longer be considered the principal cause. All the evidence points to abundance. Our favoured land compared with our great enemy's is a land flowing with milk and honey, or the less innocent modern substitutes.

Another cause of the rise in prices that has found much favour is monopoly. No doubt, in practice, whenever monopoly emerges prices tend to rise. In theory, a monopolist may possibly make a greater net profit by low prices and large sales, but in practice he never takes this kind of risk unless compelled by the Government. In time of war competition is in many ways hindered, and whatever checks competition promotes monopoly. In important cases, no

doubt, monopoly of various degrees has raised prices in this country during the progress of the war. And in this connection the opinion of Adam Smith may be recalled that "the gains of monopolists whenever they can be come at, are the most proper subjects of taxation." But though the rise in prices in some things may be due to monopoly, it cannot be said that monopoly is a wide enough cause to account for the whole of the general rise.

Whether we consider the extent of the inflation of the currency on the one side, or on the other the inadequacy of the other causes assigned, we seem forced to the conclusion that (to say the least) the inflation is at any rate one of the most important causes of the rise that has taken place in this country. This view is confirmed by reference to other countries. In other countries also there has been inflation and a corresponding rise in prices—*e.g.*, in Germany, France, and Russia. (In these cases also there has been the specific depreciation of the monetary unit in foreign exchange—a point not considered in the present paper.)

It is noteworthy also that precisely similar points arose for consideration in the great Napoleonic wars, and were treated by such writers as Ricardo, who was at the time the leading man in London in practical finance, and also the outstanding authority in monetary theory. There is, indeed, no country which does not offer at some period of its history examples of the depreciation of its currency due to inflation.

But the correct analysis of the actual rise in prices in the present war is by no means a matter of historical interest only or of the confirmation or illustration of monetary theories. The point of practical importance is that if up to now the inflation of the currency has had any influence any further inflation will from henceforth have much greater influence. If we look to the efficiency of our banking system and to the large additions to the currency already made, there can be little doubt that the saturation point has been reached. More currency notes and more silver can no doubt be thrown into circulation, and in spite of war loans bank

deposits may again increase. But this further inflation can only take place with a corresponding further rise in prices. In matters of currency we always have to bring in the qualification "after a point," because in currency, as in most other things of human interest, we pass by slow degrees from one extreme to the other. The watched pot boils at last, and boils over though the water may be ice-cold at first. In the same way we pass by slow gradations from the most perfect system of convertibility as exemplified in England before the war to the system of inconvertibility and forced paper currency as illustrated in the most extreme form in the old French *assignats*. The question is always where to draw the line—where to stop in the creation of war credits and emergency currencies. So long as the simple principle of convertibility is held to, so long as gold is held to meet all possible demands for internal use or for export, there is no difficulty, because the whole system works in an automatic way. But once any restrictions are put in the way of conversion, the working of the system depends on the judgment of the authorities. According to the old way of speaking, we have a managed currency instead of one that is automatic. In practice in a managed currency it nearly always seems necessary or advantageous to the authorities to expand the currency and credit far beyond the point that would be reached under the automatic system.

If any form of deferred or suspended convertibility is adopted and is associated with an increase of issues prices will rise just as they would have done if the notes were definitely inconvertible. Under present conditions, in which the international movements of gold are very greatly restricted and controlled, the level of prices in any one country is much more subject to purely local influences than in the normal times of peace. In normal times seventy millions of small Treasury notes, with a simultaneous increase of coins and other notes, could not have been put into circulation; nor could the American exchange have fallen to so low a figure. In times of war all this extra currency

can only be used coincidentally with a rise in prices in the home country and a fall in the foreign exchange. The mere holding of a reserve of gold in a central bank is no guarantee against depreciation. Unless that gold is used as required, it might as well be in the mines.

According to their official returns, France, Russia, and Germany hold very large stocks of gold—much larger than is the case with us—but no one will deny that these three countries are suffering from (or enjoying) a depreciation of their currency, both special and general. These three countries, on the outbreak of war, at once made their notes inconvertible. It was part of our glorification of British credit that we were not obliged to adopt this extreme measure. But we took no effective precautions to keep from drifting into the same system. We have recently been informed that the Government intend to make all their own payments in notes, and the banks are enjoined to press notes on their customers. If the gentle terms of persuasion are not sufficient, no doubt in a short time the use of gold or the refusal of notes will be penalised, as it is in Germany.

Even apart from any question of a further inflation and further rise in prices, the system of note issues ought to be put on a definite basis. The old system, except in name, has been abandoned. The new system, if there is one at all, is an official secret. Fortunately the present Chancellor of the Exchequer has reverted to the old traditions of his office, and has presented a Budget of facts and figures without disguise. What is the universal complaint? The universal complaint is that the taxes were not put on soon enough, and that now they are not heavy enough. Everyone knew that something was wrong with the body politic through its surfeit of expenditure. Will not the same Chancellor throw his searchlight on the financial measures affecting our currency and credit—the measures already adopted, and those that may have to be adopted in the near future? Is the country simply to be allowed to drift into inconvertibility, and is the system to be worked simply

according to the needs of the day in a hand-to-mouth fashion ?

The principle of limitation must be applied in some way to every form of paper money, if its value is not to fall to the value only of the paper itself. Where are we going to draw the line ? During the last six weeks the outstanding amount of currency notes has been increased on the average by more than half a million a day (including Sundays). This is nearly as much as the reported daily cost of our Navy. Apparently we have only to print off about ten times as many notes daily to bear the whole expenses of the war. It seems too good to be true—but where is the line to be drawn ?

CHAPTER XXIV

THE AMERICAN EXCHANGE AND THE ANGLO-FRENCH LOAN

(*October* 16, 1915)

LORD RANDOLPH CHURCHILL, after his hasty resignation of the Chancellorship of the Exchequer, is reported to have said at his leisure that he had forgotten Goschen. Since that time a good many people have forgotten Goschen and his work. In his day Goschen was the leading authority in the higher finance of money and banking. He was the exponent of the ideas and the methods by which London had obtained and maintained the monetary supremacy of the world. Goschen was not only a banker after the most straitest sect of banking orthodoxy, but he was an orthodox economist, who cherished both in theory and in practice the old economic principles as regards public expenditure.

If Goschen had been Chancellor of the Exchequer on the outbreak of the war—but why pursue the profitless speculation? At the present juncture, failing the living voice, we may turn for counsel to the written word; and the legislator who has to form an opinion on the American exchange problem may well prepare his mind by reading Goschen's "Foreign Exchanges." The book is a classic, and the illustrations drawn from the American Civil War are peculiarly apposite, *mutatis mutandis*, at the present time. It is, however, in the method and in the ideas rather than in the particular illustrations that the value of Goschen's work is to be found. The argument of the present paper is based on the two concluding chapters on the interpretation and on the correctives of the foreign exchanges.

The first point to seize in the interpretation of the foreign

exchanges is that they are to be regarded in Goschen's phrase as "an unerring mercantile and monetary barometer." Any unusual movement in the foreign exchanges, especially any movement beyond the limits which normally determine the import or export of gold, must be due to some exceptional cause. The first thing is to discover the cause of the exceptional movement—that is to say, the problem is one of interpretation. It is only after the true interpretation has been reached that any steps can be taken towards a correction of the movement—if such a correction should, after inquiry, seem desirable.

Nothing could be more absurd than to look on a fall in the exchange as a kind of disease which can be overcome by attacking the symptoms and not the cause. "At all events," says Goschen, "it must be borne in mind that that which is really to be corrected is not the actual position of the exchanges, but that state of things which brought it about." No one would be so foolish as to think he could amend the weather by artificially raising the barometer. The barometer, as the name imports, is a measurer, it is not a maker, of weather. When we are told that the Anglo-French loan is meant to support the exchange, the language, at any rate, is suggestive of a very old fallacy—the fallacy, namely, that the movements of international trade depend on the exchanges and not the exchanges (so far) on the trade; the conclusion drawn from the fallacy being that the Government must correct an unfavourable exchange in the interests of the nation's trade.

On this view it is said that the American exchange must be supported, or else the imports from America will be diminished, and (presumably) cease altogether with a continued fall. The falsity of this view is shown by a simple reference to facts. Since the beginning of the war there has been a more or less continuous fall in the American exchange from the highest point on record to the lowest. Has there been any falling off in our imports from America? On the contrary. Most of those who look to the interpretation of the fall ascribe it principally to the excess of imports.

And, in fact, with a record in the fall in exchange there has been a record in the imports.

International trade will adapt itself to all sorts of fluctuations in the exchanges of various countries. Any uncertainty in the exchange is only one more of the chances to be taken account of in the adjustment of the real bargain, and the difficulty may be got over in various ways.

There is, however, a sense in which an unfavourable exchange or a fall below certain limits is unfavourable to the nation at large. "The phrase," says Goschen, "is accurate enough from the monetary or banking point of view." After a certain point is reached in the fall in the exchange it pays to export gold from the country. The remittance of gold may become the cheapest way of settling a foreign debt. "Under present circumstances a merchant or banker will consider that to be an unfavourable state of things which points to a dangerous diminution of the stock of gold."

When we seek for the reason why an adequate supply of gold is the foundation of banking stability—and Goschen was never tired of telling the British bankers that their gold reserves were inadequate to meet an exceptional strain—it is found in the great principle of convertibility. "Under the present state of legislation all engagements involve payments in gold or in paper convertible into gold, the merchants engaging to pay in gold or bank-notes at their option, and the Bank of England being bound by law, without option, to pay these bank-notes in gold." Of course, even in the early 'sixties, large payments were very seldom settled in England in actual gold or notes, and since that time there has been a still greater development in the economy in the use of gold. But at any rate, up to the outbreak of the war, the whole banking system rested on the principle of convertibility as laid down by Goschen. In other words, London was a free market for gold.

In other banking centres there was not the same freedom as in London in obtaining the gold—*e.g.*, in Paris or Berlin, though in both places much larger stocks of gold were kept.

Under the British system the gold was not regarded as a hoard which ought to be increased as much as possible. The idea was only to keep in hand such an amount as would suffice, under any circumstances, to meet the demand. As Goschen said—"When the stock of gold is evidently adequate it is even, in a banking point of view, erroneous to consider a further accumulation advantageous or desirable. . . . the temporary excess of gold at one point is of no advantage whatever, but rather the reverse." The United States at the present time seems to have reached this stage of repletion.

Under the system described by Goschen the principle of convertibility was interpreted most strictly. The issues of bank-notes were severely limited by law, and suspended or deferred convertibility was not admitted. It is true that in other countries, and notably in India, this strict principle of convertibility had been departed from under the various devices of what is now called the gold-exchange standard. Under this system it is supposed that if the foreign exchanges are artificially kept within the normal limits the principle of convertibility is sufficiently observed. Under this system it is the duty of the Government to support the sterling exchange, that is to say for external purposes. (On this plan the Indian exchange has been supported, though there has arisen in India itself since the war a heavy premium on gold.)

In England, however, up to the outbreak of war no inroads had been made on the old principle of convertibility either as regards internal circulation or foreign payments.

The outbreak of war naturally, and perhaps necessarily, led to considerable changes. The effects of these changes have been cumulative. As shown in a previous paper, there has been an enormous increase in the output of paper money and also of silver token money. Last week there was again the usual increase of over three millions in the amount of the currency notes outstanding. Coincidentally, even if the causal connection is denied, there has been a general rise in prices or a general depreciation of the pound sterling.

Such a general rise in prices, according to the principles adopted by Goschen, tends to encourage importation and to discourage exportation. Coincidentally (if again the causal connection is denied) there has been an abnormal excess of imports over exports—the returns for September, as well as for the nine months of the year 1915, being very striking. No doubt other causes are also at work—no one supposes that the excess of imports is due entirely to the inflation of credit and currency in the home country. But all experience shows that such a cause is operative and is cumulative as long as it lasts. The normal sequence of events in any inflation is in the following order :—Inflation, over-importation, adverse balance, drain of gold, check to credit, commercial crisis. If the later stages are not reached it is only because the inflation has been checked in time, or the export of gold has been hindered.

According to the exposition of Goschen, an export of gold (or such a condition of the exchanges as would naturally lead to such export) may arise in three ways—it may be the result of the settlement of indebtedness, or of differences in the value of money (*i.e.*, in the sense of rate of interest), or of differences in currency. The correction of the exchange (or the check to the outflow of gold) must depend on counteracting the dominant cause.

Under the old system a drain of gold due to excessive imports was met by a rise in the Bank rate and a corresponding contraction of credit and prices. This contraction led to a fall in prices. The country was no longer so good a market for imports, and the cheapness encouraged the exports. In this way the outflow of gold was checked or reversed.

Under the system that has been in force since the war this mode of adjustment has been altogether inoperative. There has been no pretence of correcting the adverse balance by any kind of contraction. The Bank rate has remained fixed, and most of the emergency measures adopted for the facile creation of credit are still in use. How can contraction be effective when, for example, the Bank of England is

bound to advance on the old War Loan at the price of issue at 1 per cent. below Bank rate? And this is only one example of the aids to inflation. For all internal purposes currency notes replace gold, and the issues depend on no recognised principle of limitation.

As the old methods of correcting the falling exchange have become obsolete other methods have been substituted. People are implored not to use so many foreign imports, and to check their consumption of exportable things. But though the heavens should fall—let alone the exchanges—the true Briton will spend his extra money according to his appetites. Now that any hypnotic suggestion of moderation has been found to be a futile remedy, the compulsion of taxation of imports has been resorted to, but, unfortunately for the success of the remedy, only in homœopathic doses.

In the meantime, failing other correctives of the exchange, the Anglo-French loan in the United States holds the field. In itself the loan seems quite a simple and efficient expedient. Having regard to the war conditions prevailing, the usual American methods of business, the various interests to be conciliated, etc., the terms of the loan seem quite reasonable. They are not easy to reconcile with the large ideas of the inexhaustibility of British credit that were so dominant a year ago, but that is a matter of no importance in the midst of the constant flux of opinion on every aspect of the war. The new loan is a payment by means of promises to pay instead of by means of gold or other things for an excess of imports, which excess is due to the war. It is an exceptional remedy for an exceptional case. The natural presumption is that the loan is to be expended solely in payments for most necessary Governmental requirements. The loan in itself cannot restore the exchange to its normal limits. And as soon as the proceeds are spent the adverse balance becomes so much greater on account of the payment of interest. Then will come a new loan, probably on harder terms and more interest. Still, when we look to the amount of our own war loan and to the needs of the immediate

future, the American loan just arranged for may be considered good business.

But it is difficult to follow the reasoning by which the chief merit of the loan is said to be in the support given to the exchange. Is it intended that the Government should attempt to stabilise the American exchange by the methods applied to India? Unless some artificial management of this kind is attempted, the only effect of the loan will be through the direct diminution of the adverse balance. So far as this adverse balance may be due to inflation, the American loan will rather aid than diminish the influence of the inflation.

But whether we look to the internal circulation and the state of prices, or to the outward flow of gold and the foreign exchanges, some check on the continued inflation seems desirable.

In Goschen's interpretation of the exchanges the first element looked to was always the indebtedness. But the next was the state of the currency and circulation. The moral of the present argument may be conveyed in a quotation from Goschen on the effect of the issues of notes in the American Civil War: "Strangely enough, the depreciation was actually delayed far beyond the time when it was expected to occur, and the Americans began to believe that it was possible to print paper money without losing gold or depreciating the remainder of the currency." Apparently we are afflicted with the same belief.

CHAPTER XXV

LIBERTY, CONSCRIPTION, AND ECONOMY

(*November* 13, 1915)

THE crimes committed in the name of liberty have become proverbial. Most of the crimes are the result of not understanding the nature and meaning of liberty. Sometimes the meaning is construed too loosely, and liberty degenerates into anarchy. Some forms of the opposition to the methods of compulsion in military service are purely anarchical. Similar arguments would destroy the compulsory power of taxes or legal punishments. Fortunately, this misinterpretation of liberty has not survived exposure to the light. No reasonable man would now maintain that under no circumstances ought compulsory service to be adopted. The practical question is whether it is worth while to resort to compulsion. The right to use the compelling power is admitted, if only in the grudging form that needs must when the devil drives.

But though the anarchical interpretation of liberty has been abandoned, and we no longer hear of threats of a general strike against conscription in any form, the fair field for argument on the merits is still cumbered with other misunderstandings. There is the dread, for example, still expressed in some quarters that the adoption by us of compulsory military service would engender a spirit of militarism. By the natural associations now clinging to the word, militarism is supposed to mean Prussianism, and, with so awful a disease, the old advice to check the beginnings seems at least excusable. A little sober reflection, however, will show that compulsory service is not of necessity a forerunner of the Hohenzollern pestilence. Nor does training in the use of arms and in submission to military

discipline imply any weakening in the love of personal freedom and in the admiration for our hard-won political liberties. On the contrary, a general appeal to history shows that compulsory national service has been commonly adopted by the most liberty-loving peoples. The danger to liberty has arisen not from national service, but from standing armies and mercenary troops. "Men of Republican principles," says Adam Smith, "have been jealous of a standing army as dangerous to liberty. . . . The standing army of Cæsar destroyed the Roman Republic. The standing army of Cromwell turned the long Parliament out of doors." But, as Adam Smith is careful to point out, even a standing army is only dangerous to liberty when the interests of the commander and the principal officers are not in accord with the principles of the constitution. To take a modern instance, the interests of the Kaiser and his military caste have strangled the liberties of the German constitution. On the other hand, the spirit of France and the spirit of Russia in the present war are unquestionably ennobled by the idea of the duty of national service.

The opinions of Adam Smith on liberty, conscription, and economy are specially deserving of attention in this country at the present time. Adam Smith was the greatest of economists, and his greatness is partly due to the fact that he always took a large view of his subject—he never fell down and worshipped a rigid code of formal precepts. If his teaching is to be summarised in one sentence, the sentence must say that he was the great apostle of liberty. His whole economic system is known as the system of natural liberty. His ideas on liberty were akin to those of the great French philosophers, his contemporaries, who were sowing the seeds of the French Revolution. The difference was that Adam Smith tempered his liberty with a fuller knowledge of the nature of mankind as revealed by actual history and experience. The work of Adam Smith bristles with facts. That is one reason why it always appeals to the practical man—that is to say, his real work, and not the cut-and-dried formulæ into which it has been reduced.

But the chief reason why the "Wealth of Nations" has retained its great popularity is because it is pervaded by the spirit of liberty. Everybody feels at some time or other that too much Government is a nuisance. The natural man may like well enough to govern other people (especially if he is well paid for it), but for himself he likes to be let alone, and he hates taxes. Anyone who wishes to make an effective attack on any Governmental abuse cannot prepare his spirit better than by reading a little Adam Smith—the great master of liberty and economy.

Adam Smith treated of the questions that are just now agitating the British mind under two headings—namely, the Expense of Defence and the Expense of the Education of Youth. Both Defence and Education come into the range of economics because they involve expense, and since Adam Smith wrote the expense of both has increased enormously. In considering the expense of these institutions Adam Smith was led into a more general treatment of national defence and national education, and of the very close interconnection between the two. Those who have a vague idea that Adam Smith was the father of a peace-at-any-price policy will be surprised to hear that no present-day writer has ventured to put the case for universal military training with the elemental moral vigour of Adam Smith. Here are the main steps in the argument, and be it observed they are taken from the section that deals with the education of youth :—

"In the progress of improvement the practice of military exercises, unless government takes proper pains to support it, goes gradually to decay, and together with it the martial spirit of the great body of the people. . . . But the security of the society must always depend more or less upon the martial spirit of the people."

Adam Smith does not look on the martial spirit of the people simply as a cheap mode of insurance for liberty. He goes on to say :—

"Even though the martial spirit of the people were of no use towards the defence of the society, yet, to prevent that sort of

mental mutilation, deformity, and wretchedness which cowardice necessarily involves in it from spreading themselves through the great body of the people would still deserve the most serious attention of government; in the same manner as it would deserve its most serious attention to prevent a leprosy or any other loathsome or offensive disease from spreading itself amongst them."

If we remember that the system of natural liberty rests on the idea of individual freedom, the following sentence is in complete harmony with that system:—

"A coward, a man incapable of defending or of revenging himself, evidently wants one of the most essential parts of the character of a man."

Fortunately for the British Empire the martial spirit of the great body of the people has not decayed, although we have no modern substitute for the old compulsion of the practice of archery. The British Empire, with its variety of interests in all parts of the world, has had continual reminders that the paths of peace need safeguarding by something stronger than the mere love of peace. The martial spirit has been kept alive by little wars and rumours of greater wars, and an unwavering belief in the British power of the sea. Happily, in the hour of need not one of the nations of which the British Empire is composed was too proud to fight. At the same time, it must be admitted that amongst a certain number of the people there has not been that alacrity to show the martial spirit in practice which might have been expected if the duty of military service had been inculcated by actual training in youth.

But it is not only on the moral excellence of the martial spirit that Adam Smith founds his argument for national training. He approves indeed of martial training—as just shown—even if it were not necessary for defence, but the solid foundation of the whole argument is that the defence of the nation, even from the point of view of the most elementary security, cannot be altogether left to the voluntary action of the people.

This part of the argument is specially enforced in the

section that deals with the expense of defence. The basis of the whole argument is that the trade of the soldier cannot be left to the voluntary action of individuals. In industries the choice of occupations may be left to the natural play of demand and supply. Division of labour, which in the extended sense means the varied occupations of the people, is naturally introduced by the prudence of individuals who find that they promote their private interests better by confining themselves to a particular trade.

"But it is the wisdom of the State only which can render the trade of a soldier a particular trade separate and distinct from all others. . . . It is the wisdom of the State only that can render it for the interest of the private person to give up the greater part of his time to this peculiar occupation, and States have not always had this wisdom even when the preservation of their existence required that they should have it. . . . An industrious, and upon that account a wealthy, nation is of all nations the most likely to be attacked; and unless the State takes some new measure for the public defence, the national habits of the people render them altogether incapable of defending themselves."

Until the conduct of the present war showed that Germany takes a very serious view of the right of the exaction of maximum indemnities from the conquered, the idea had come to prevail that a wealthy nation, if it happened to be on the other side of the Atlantic, was not open to attack, and was sufficiently protected by its own peacefulness and the tradition of the Monroe Doctrine. It now appears that even in the United States the argument of Adam Smith is being accepted both as regards the dangers of attack and the necessity for defence. As regards our own country, if this time we escape from the consequences of unreadiness, the lesson is not likely to be soon forgotten.

According to the teaching of Adam Smith, although the wealthy nation is most liable to be attacked, it is also, by reason of its wealth, the most capable of defence. "In modern wars," so he wrote, "the great expense of firearms gives an evident advantage to the nation that can best afford that expense; and consequently to an opulent and

civilised over a poor and barbarous nation. In ancient times the opulent and civilised found it difficult to defend themselves against the poor and barbarous. In modern times the poor and barbarous find it difficult to defend themselves against the opulent and civilised. The invention of firearms, which at first sight appears to be so pernicious, is certainly favourable to the permanency and to the extension of civilisation." Adam Smith did not foresee or discuss the case of most interest at the present time—namely, that of the nation that is barbarous as well as wealthy.

The relation of wealth to military power leads up to the third division of the present text—namely, economy. At the outbreak of the war we took it for granted too easily that the greater the wealth the greater the power for endurance. We looked with complacency at the aggregate value of our national wealth. We forgot that the greater part of this realised wealth could not be mobilised for war. The State might take the whole of the rental of lands and houses, but it could not take the lands and houses themselves for consumption in war. It is the opinion of most economists that the national income is a far better test of the national wealth than is the capitalised value of that income. The national income of the United Kingdom in normal times is reckoned as somewhere about 2,000 million pounds. The present rate of our war expenditure at five millions a day works out at nearly 2,000 million pounds a year. No wonder that the Prime Minister in his most important speech since the war began described the financial situation as serious. The only consolation now offered is that the situation of Germany is more serious. In this comparison of burdens, however, it is fogotten that we cannot adopt the German methods of exploitation or so-called organisation.

The most complete system of conscription will be useless, or worse than useless, unless it is accompanied by far greater economy in the use of our wealth. In war as in industry labour is only one of the factors to be reckoned with. It seems probable that the admirable effort of Lord Derby will directly or indirectly give the State the command of all

the labour fit for military purposes. What we have now to realise is that this labour cannot be effectively used for the period of the war unless we practise the strictest economy in every sense of the term ; and the word "economy" has at least two meanings applicable to the present case.

There is economy in the simple sense of saving or of refraining from present gratification with a view to the future. In this simple sense people are asked to eat and drink less and so on, and put the money saved into the War Loan. The State will then use the money for the defence of our interests, that are far greater than wealth. This aspect of economy, as we are reminded by Professor Edgeworth in a recent discourse was expressed in noble language by one of the greatest of Scotsmen—namely, Dr. Chalmers, who was moved by the menace of Napoleon. "Exchanging luxury for security and independence," that is the moral profit that is offered to the soul of the nation. "Instead of splendour and luxury they will receive liberty and protection, and the conscious importance which ever accompanies the feeling of being an independent people." "These are the feelings," said Chalmers, "and they are worth purchasing." But Chalmers did not rely only on voluntary sacrifice and on the appeal to patriotism. "Taxes," he said, "will whip us on to improvement"—that is to say, in the exchange of the luxuries of peace for the necessaries of war. The statistics of our consumption during the present war show clearly enough that this whip must be laid on with more vigour.

But there is a second meaning of economy that is of equal importance at the present time. Economy in this second sense means the lessening of cost in the attainment of any object. It implies that of the many methods possible the least expensive, if it answers the purpose, is the test. Economy in the first sense gives the State the money ; economy in the second sense makes the State use the money to the best advantage. The course of the war has shown that it is this second kind of economy that has been most neglected. Hitherto, with the aid of loans, plenty of money

has been forthcoming, but at every point the economy of expenditure has been neglected. This is not the occasion for any enumeration of details, but one preliminary condition of successful economy may be emphasised. It is no use making economies in one direction and spending more in another. Surely with expenditure at five millions a day it is time to enforce the principle of rigorous limitation. Let no expenditure of any kind be taken up unless the money is obtained from some less urgent need. Before any Member of Parliament boasts that he has obtained some increase of public expenditure for some estimable object let him show that he has saved the money from some less estimable mode of expenditure. What is wanted is not a readiness on his part to vote for more taxes for his favoured scheme, but a definite indication of a source of saving of waste.

CHAPTER XXVI

THE GRAVITY OF THE FINANCIAL SITUATION

(*December 22, 1915*)

"We have got into a position which I think is extremely dangerous, and for this reason. As long as we can borrow money freely to any extent that is required there is a fictitious prosperity spread over the whole country, and instead of making sacrifices people are better off than they ever were before." These were the words of Mr. Bonar Law, speaking as Leader of the House of Commons about a month ago, in the absence of the Prime Minister, who had himself described the situation as serious a little time before. It might have been supposed that such utterances would have been the prelude to a serious attempt to reverse the policy which has brought the country to this "extremely dangerous position."

"Instead of making sacrifices," said Mr. Bonar Law, and since he spoke what signs are there of any greater readiness to make sacrifices? At the outset of the war the spirit of self-sacrifice was high throughout the land. The spirit of self-sacrifice still beats high where the lives of men are concerned. That the voluntary system should have called forth millions of men to face the horror of modern large scale war is marvellous. But in the matter of money self-sacrifice has been displaced by self-seeking. Getting and spending, we lay waste our powers: "Bear ye one another's burdens" has given way to "share ye one another's bonuses." Common sense tells us that a time of war ought to be a time of stress. More work and less enjoyment—more self-help and lessened appeals to an over-burdened Government—these ought to be our guiding rules. The

very opposite has been the case. Public and private extravagance have combined to make the financial position "serious" or "extremely dangerous"—the words are the words of the leaders of our two great political parties.

Mr. Bonar Law finds our greatest danger in the fictitious prosperity of the country at large. How can such prosperity have arisen in time of war? The most obvious answer is the extravagant expenditure of public money raised by loans. The loans are professedly war loans. The proceeds ought, therefore, to be spent in the conduct of the war. The test of proper or improper expenditure ought to be in every case—How far does spending this money help to win this war? How much is necessary, and how much is ornamental or even wasteful?

Mr. Bonar Law had specially in view the rise in wages. The rise in wages still goes on. The Chancellor of the Exchequer and the Prime Minister united their efforts to implore the working classes not to ask for more wages, and the next week the papers announced another bonus to munition workers, this time the amount named being four shillings. Since then there are rumours of demands on a larger scale to compensate the rise in the prices of necessaries. The bonuses are spent, and the mischief circulates.

Since we all became socialists—the saying is now respectable by age—a rise in wages of any kind has come to be looked on as a sign of national progress. Whether this opinion is just or not depends on the cause of the rise in the wages and also on the ways in which the extra earnings are spent. The principle of "the economy of high wages" is based on a deep-seated feeling of human nature. Increase a man's share in the product of his labour, let wages rise in proportion to useful effort, and the efficiency of that labour will surely increase. The magic of property turns sands into gold, and the curse of slavery turns gold into sands.

There is equal truth in the principle of "the morality of high wages." There are things made by sweated labour that ought either to be made with higher-priced labour or

not made at all. Better for a nation a system of outdoor relief than a system of indoor sweating.

Both of these principles may be also applied to the expenditure of the money wages. If the money is spent on things that make for efficiency or humanity, then is the rise in wages doubly blest—it blesses not only the master that gives, but the man who takes. But if the wages are spent on drink and the devil and other baneful vanities, then both the work and the man are the worse of the high wages.

Precisely similar reasoning may be applied to profits. Our working classes have been so much preached to and preached at in the matter of war bonuses that other kinds of war bonuses have been lost sight of. "Our merchants," said Adam Smith, "often complain of the high wages of British labour, but they are silent about the profits of stock." The moral for to-day is obvious. The difficulty is in applying the moral.

Profits and wages under normal conditions may be regarded as the universal elements in cost of production. If a thing is to be produced in a regular way to meet a regular demand the various sets of producers concerned must get the normal rates of remuneration, or they will transfer their capital and labour to more attractive fields. From this point of view it is true that the relative prices of products are normally proportioned to their relative costs in wages and profits.

The threefold rise in the price of munitions which Mr. Bonar Law mentioned is often accounted for by the rise in the corresponding wages and profits. But in this case there is another and a much truer way of looking at the relation between prices on the one side and wages and profits on the other. When the prices of products rise owing to an abnormal increase in demand, the fortunate producers obtain for the time being what the modern economist calls a *quasi*-rent. A *quasi*-rent of this kind is just as much an unearned increment as a rise in the rental of land. In any expansion of trade, or more generally in any period of

inflation, such *quasi*-rents abound. In this country during the present war they have grown up like mushrooms. It is a remarkable instance of the mutability of fortune that the present Minister of Munitions should have planted and watered so many of these fungi. It is to be hoped that his efforts in gathering in part of the increase may be more successful than in the case of the unearned increments of land.

The present period of fictitious prosperity, with its wealth of bonuses and *quasi*-rents, is no doubt due in the first place to the enormous increase in the demand by the Government for all sorts of things. When people speak of the demand for things raising their price, they often forget that all demand implies two elements—the desire to possess, and the means of purchase. Desire without money and money without desire are equally ineffective. The British Government in the matter of desire felt the urgent driving of military needs. A war demand is overpowering in its urgency. The urgency is decided by military officers, and their word is final. The money power of a war demand is also unlimited; it is backed by the whole credit of the State, present and prospective. At the outset of the war we were altogether unprepared for a great land war. Our military needs were extreme. At the same time our credit was unexampled. Hence these *quasi*-rents and war bonuses. We began with emergency measures, and the emergency idea is still dominant after sixteen months of war. One would suppose that our armies were rushing on the enemy with the most furious haste instead of being stuck fast in trench warfare. A war of attrition ought to give ample opportunity for a revision of measures that were undertaken in the beginnings of a war which threatened to be a matter of weeks unless we made up for lost time in frantic haste.

We have been told from the beginning that we were bound to win this war by our greater financial endurance. If we only escaped disaster at the beginning all would go well. Our money machine would beat the German war machine. This hope was strengthened by confidence in our sea-power. By our credit and our sea-power we could

draw on all the world. The forecast in our favour seemed most reasonable if only we were allowed time enough. The contest between the two machines has not been of the expected character. Germany has wasted men, and we have wasted money. The Allies are now getting the advantage in military power, but our Ministers tell us that the financial strain is becoming serious. The greatest possible tragedy in this war would be a premature peace through the collapse of the monetary system. Of all the powers for good and evil in our modern world, the money power is the most timid and the most fearful for its own existence.

One particular group of war bonuses, the most important of all, has been most overlooked. These are the bonuses that have been given to the dealers in British credit. If we talk in the language of wage-earners, the very first demand pressed on the Government was that the standard of comfort of the great financial houses should be kept up. Much may be excused in the panic that arose in the first days of the war. The relief measures and preventive measures adopted were, as we can now see, excessive, although they were perhaps errors on the safe side. But why should the emergency measures have been continued long after the panic had subsided, and the dealers in credit were suffering from repletion?

From time to time in these papers attention has been called to the successive expedients of the Government in supporting the dealers in British credit. On this occasion it is sufficient to recall the cumulative effect. The most important result of all this Governmental assistance to the monied interests has been an inflation of credit and of paper money, which has rendered possible and maintained the general rise in prices that is now so marked it cannot be denied. The *Economist* index number for November shows that the rise continues at an increasing rate. All experience proves that you cannot greatly increase the amount of paper money in circulation without raising prices. In normal times such an inflation is brought down by the necessity of providing a sufficient substratum of gold or of notes definitely

based on gold. But the paper money of the Government, now approaching a hundred millions, and growing regularly every week by about three millions, takes away all need for the provision of gold for internal use. The banks no longer fear an internal drain, because the Governmental cistern is always kept full. The external drain is not so easy to manage. Paper money cannot be exported. But again the Government is called on for assistance, and the Government, with its wonted complacency, is to become the biggest stock-jobber in the world.

There can be no question that the general rise in prices, to whatever cause it be attributed (*e.g.*, scarcity, which is absurd, or war, which is vague) is the proximate cause of that fictitious prosperity which Mr. Bonar Law deplores, and, to say the least, is a contributory cause in all our financial difficulties. Why do the wage-earners demand rises in wages? Only to meet, so they say, the rise in prices. Why is the Governmental expenditure rising so rapidly? Because all the requirements of war are costing more money. Why, with all our credit, is it so difficult to correct the foreign exchanges except that our balance of indebtedness is so largely swollen by the rise in prices? Whatever way we turn it is the rise in prices that is the one persistent cause that intensifies the trouble.

According to the authorities who have explained the system by which our financial greatness has been achieved—*e.g.*, Ricardo, Goschen, Bagehot, all of them practical men as well as economists—the principle of limitation is the only safeguard against the evils of inflation. This is the one principle to which the present leaders of finance turn a blind eye. In the discussion on the Finance Bill in reference to the limitation of the paper currency, it was said by Mr. Montagu: "The Treasury takes from day to day and from hour to hour the advice of those engaged in this matter in the City." Nothing could seem more reasonable and reassuring—but for one objection. It is no part of the business of the City or of the bankers or the great financial houses to consider the effects of their credit operations on

the general level of prices. Their business is with particular credits and particular prices. General prices, so they think, apparently, depend on the act of God or the King's enemies, and not on the dealers in credit. What concern is it of theirs if the *Economist* index numbers rise or fall? What have they to do with real wages and consuming power? Their business is only with money, and especially the paper substitute for money. The old-age pensioners and the M.P.'s and other people with fixed salaries must take the prices as they come.

Is there, then, no hope? Is the political economy of to-day to be even more dismal than the political economy of yesterday? The answer is that in matters of finance it is never too late to mend. In the midst of a great war we cannot gather up the wasted credit, but we can put a check to further extravagance. Our position, economic and financial, in spite of all our waste, is still very much stronger than that of Germany. We read lamentable tales of the German ladies having war bread without butter—it seems as if the want of butter would end the war; but as for all the inhabitants of these fortunate isles, "their eyes stand out with fatness; they have more than the heart could wish." Germany is already on the margin of want, but we have not yet begun to economise. All that we have to do is to put in force a little healthy abstinence, and half the battle is won. But the healthy abstinence must be applied first of all by our rulers. So long as they pour out the money, the people will spend it. Strange as it may seem, if there were not so much money in circulation, people would not have so much to spend. What we need is a small threatening of a crisis—not a cataclysm, but a slight warning tremor. The tremor cannot be far off. British credit in five-year bonds is offered at 5 per cent. to the foreigner without deduction of taxes. The American investor has only taken up sixty out of the hundred millions of the Anglo-French Loan. The next loan is to be supported with collateral. The principle of limitation has many ways of coming home, but it always arrives. Let us hope it will arrive in time.

CHAPTER XXVII

EQUALITY OF SACRIFICE IN WAR-TIME

(*January* 15, 1916)

ONCE on a time, perhaps after too long gazing on the darkness visible of the modern mathematical political economy, Mr. Balfour spoke of the "thin lucidity" of John Stuart Mill. Delusive simplicity would have been nearer the truth, for Mill was the begetter of many maxims which seem simple and certain, but when tested by facts are doubtful and complex. Of such is the dictum—"Equality of taxation means equality of sacrifice."

Much of the weakness of our war finance has arisen from the non-critical application of this maxim. It was most desirable that from the outset of the war the working classes should contribute their share to special war taxation for various reasons—to aid the public revenue, to check extravagant consumption, to lessen our indebtedness to foreign States, and, above all, to impress on the great body of the electors the absolute need for the most economical use of our resources. This was the meaning of the tradition that there should be some kind of proportion between direct and indirect taxation—the idea being that the direct taxes fell for the most part on the classes and the indirect on the masses. The tradition was still observed in the Boer War, a war of very small magnitude compared with this present war. In the Boer War the nation, which at that time regarded Free Trade as the accepted national policy, consented to a war tax on imported corn. The principal argument advanced in favour of the tax was that in time of war the general body of the people must be made to feel their share of the burden.

During the first year of the present war this healthy tradition was abandoned. The income tax was promptly doubled, but there was no equivalent increase in taxation meant to fall on the masses of the people. The tax on beer had the unfortunate result of driving the beer-drinker to spirits. The modest increase in the tax on tea was the only general war tax attempted in the first year. Last May Mr. Lloyd George showed the need of more taxation, but imposed none. In the autumn the present Chancellor of the Exchequer lowered the income tax limit of exemption to £130 and increased the tax on tea, but at the same time the income tax falling on the old income tax-payers was increased by another 40 per cent.

The general result of our war taxation has been to impose real and considerable burdens on professional people and others with fixed or lowered incomes. In the case of the commercial and trading classes, besides the usual income tax an excess profit tax has been levied. But no effective war taxation has been imposed on the masses of the people. On the contrary, through the general adoption of a system of war bonuses the material condition of the people has been improved.

Adam Smith, when laying down the fundamental principles of taxation, compared the people of a country to the joint tenants of a great estate. It was their duty to provide for the upkeep of the estate. Everyone ought to contribute in proportion to his ability. That was Adam Smith's idea. That is not our idea. Our great estate was threatened by a vast inundation. We proceeded to borrow immense sums on mortgage to secure the estate against the flood of destruction. Having got the money and checked the inundation with part of it, we used the rest to celebrate the occasion. We converted the threatened deluge of barbarism into a flood of felicity. What a miracle! Never was there such a sudden improvement in the masses of the people of a country since the celebrated outburst of public credit under John Law in France two hundred years ago. All the returns of official figures tell the same tale. Never were the figures

for pauperism and unemployment so low; never were the records of imports and of wages so high.

And yet everyone feels that there is something wrong about this miracle, both economically and morally. We live in a state of fearful expectation that the false miracle will be followed by a plague in the old Egyptian fashion. In the meantime the more curious want to know how the magicians have worked the miracle. There are, no doubt, many causes of the fictitious prosperity, but one great cause is to be found in the false ideas engendered in the people by this innocent-looking maximum of equality of sacrifice. In the modern mode of speech, they have been hypnotised by false suggestions of sacrifice.

The first evil suggestion is a kind of Communism that puts on an appearance of justice and humanity. The real sacrifice (it is said) involved in paying taxes will vary, not only according to wnat is taken, but according to what is left. The idea in itself seems most reasonable, and may be supported by the highest authority. When the widow cast into the treasury two mites (which make a farthing), the great Lord of Sacrifice said to His disciples that this poor widow had cast in more than the rich men; for they cast in out of their abundance, but she of her penury cast in all the living that she had.

The modern protector of the poor has bettered this instruction. There is no possible comparison, he argues, between the sacrifice of necessaries and the sacrifice of luxuries. To take a mite from the poor involves far more real sacrifice than to take a million mites from the rich man. We can only begin (so he says) to apply the idea of equality of sacrifice rightly if, first of all, we exempt from all taxation a necessary minimum income. Then for the incomes above this limit we must adopt a rapidly-increasing progression. In every case we must shear away superfluities before we touch on the comparative necessaries. The old name for this thoroughgoing process of equalisation was "levelling," and the supporters of the plan were called "levellers."

The people of this country have never carried the idea

of levelling to an extreme. We can hardly think of London having a Commune even after an unsuccessful war. But the idea that a certain minimum income should be free from taxation has gained a considerable hold, and the minimum is placed pretty high. It is this notion that has dominated our statesmen in their abstinence from effective war taxation of the masses. They have assented to and encouraged the belief of the working classes that they have a natural right to the pre-war standard of comfort; that for every rise in the cost of living there ought to be a corresponding bonus on wages; and that the bonus ought to be given even if the rise is due to taxation.

If the term "minimum income" is interpreted strictly, its exemption from taxation may be defended on purely economical grounds altogether apart from any ideas of sacrifice. If the exaction of a tax would send the payer over the margin of self-support the tax must be returned to him (with expenses) in the shape of poor relief. We cannot tax people to death. Or again, if the tax on the minimum income really lessens the productive power of labour by reducing the standard of life the nation may lose much more than the revenue yielded by the tax.

But obviously these arguments do not apply to incomes above the efficiency minimum. Moreover, in considering what is the efficiency minimum under any circumstances, and in estimating the real burden of any general taxes, we ought always to take account of what is returned to the taxpayer in the benefits which he obtains from public expenditure. Even in peace-time, if an ordinary working man puts a money value on the education of his children, and on the contributions of the national and local governments to the public utilities in which he has the greatest share, he would often find that on balance his taxes would leave a considerable bonus.

If we apply these ideas it is quite clear that the working classes of this country were well able to bear their share in war taxation. But for the most part their actual condition has been bettered by the war, and on balance, instead of

paying taxes, they have received bounties. No doubt there are exceptions. The war bonuses have not been very evenly distributed. Some people—*e.g.*, the old age pensioners—have had no bonus, and have suffered instead from the rise in prices. Some people have had too many bonuses. They have waxed fat and kicked. They have been soothed and flattered, but they are not happy. They are suffering from the ill-temper that follows indigestion. On the whole, however, the great masses of the people are taking their bonuses gladly, and are being attested, and giving other evidences of a healthy public spirit. But the best friends of the people cannot pretend that in the mass they have been called on to bear such an amount of taxation and consequent privation of comfort as might be expected in a great war, according to the principle of equality of sacrifice.

In the Napoleonic wars the modern version of equality of sacrifice had not been discovered. There was not a person, or commodity, or occasion that escaped taxation. On everything whatever, living or dead, on every occasion from birth to burial, taxes were imposed of all degrees of inequality. In those days taxes were real plagues fittingly comparable to locusts and hailstorms. What was the general condition of the people who were called on to bear these taxes? "The privation and misery which fell on the lot of the poor was exceedingly great." Such is the summary of the simple annals of the poor in Porter's "Progress of the Nation." How could it be otherwise when we look to the records of wages and the cost of food? In Glasgow, for the six years which ended with Waterloo (1810–15) the weekly wages of carpenters were 18*s.*, and of shoemakers 15*s.*; and if the lordly plumber got 22*s.* 6*d.*, the common labourer, on the other hand, had only 11*s.* Over the same six years the average price of wheat was 93*s.* per quarter, and ranged between 122*s.* and 63*s.*

The comparison of our burdens with those of the other belligerents in the present war is not much more flattering to our self-respect from the point of view of sacrifice. We are no doubt an easy first in the accumulation of war debt

per head of population. Our five millions a day war expenditure (and perhaps by this time it is six) has an imposing appearance. But spending the proceeds of debt is not sacrifice to the people who do the spending. Let us leave out the money or forget where it comes from and search for the real sacrifices of comforts amongst our stay-at-home masses. The consumption of the people has increased. So far as material comforts are concerned, taking the average mass of the people, there are no sacrifices.

Compare our people with the people of Germany. Germany is also piling up debt. Germany has not yet begun to put on new war taxes. But there is no fictitious prosperity for the masses of the German people. Instead they have their meatless days and their fatless days. "Cauld kail made het again," they are officially assured, is excellent if helped out with a mealy potato. According to their own reports, the artificial liver sausages and the other substitutes for food made by the German chemists are amongst the nastiest and dearest things ever tried by a besieged people. Our Allies—that is to say, our greater Allies—are no doubt better off, but they read with amazement of our style of living, and graciously say it is part of the English madness.

Nor is the appeal to equality of sacrifice much more satisfactory when we look to the distribution, apart from taxation, of the whole burden of the war on our own people. One man gives up his life and another takes his job at a higher wage. Thousands at the front rush to their death on entanglements which might have been cleared away (so we are told by the Minister of Munitions) but for the slackness of a few thousands of highly-paid workers at home. We are about to apply compulsory military service to our young unmarried men. What is the principal objection raised? The fear that a corresponding compulsion will be applied to the makers of munitions and other providers of the industrial needs of war. Why not? What has become of that principle of equality of sacrifice which is so much respected when it means exemption from taxes?

By all means let us strive to retain as much as possible

of the ideals of peace. Far be it from us to accept the German teaching of the art of war: that success justifies any means whatever. But in a state of war we must be prepared to revise some of our ordinary rules of conduct, and try to discover what other rules are better fitted to achieve our real aims.

We are fighting, in the first place, for national liberty. There is no need to wander off into metaphysical discussions on the meaning of national liberty. Look at Belgium, look at Serbia. The kind of liberty these countries have lost, that is the kind of liberty we are fighting to preserve for ourselves, and also, as in honour bound, to restore to them. In order to achieve this greater liberty, the lesser liberties of all kinds must give way. Even those liberties which in time of peace seem fundamental may be ranked as lesser in the new perspective of war. Of such is the liberty of every man to do as he likes with his own labour. "The property which every man has in his own labour," says Adam Smith, "as it is the original foundation of all other property, so it is the most sacred and inviolable." Yet the same Adam Smith approved of compulsory military service. The members of trade unions look with the greatest jealousy on any infringement of the "liberties" which they have obtained by a hundred years of struggle. Even if we grant to the full the claim of the unions as the guardians of the liberty of labour—a large claim—or if we allow that a time of war is not a time to dispute the claim, still the unions must be asked to sacrifice their lesser liberties for the greater national liberties. They must have a very poor belief in their own power if they think a concession of this kind will imperil their position in peace. Their position is much more likely to be imperilled if by their restrictions they shorten or delay the supply of war material.

The greatest truth about war is that war must involve sacrifice, and the greatest error is to imagine that the sacrifices can be made equal in the case of individuals. The most the State can do is to avoid or mitigate glaring inequalities. But always equality of sacrifice is of secondary import-

ance to the sacrifice itself. Everyone knows and feels that in this war he ought to be making some sacrifice, and it is unworthy of this feeling to hold back through the fear that he may be doing more than his neighbours. If he should do more than some, it is quite certain that he will not get near to the sacrifice of others.

Still less should the Government allow its hands to be weakened by undue deference to equality of sacrifice. By all means, keep to the rule if the needs of the State admit of its observance. But taxes that are intended to raise revenue or to check consumption are not to be frittered away in exemptions in the vain search for equality. Lay on the taxes, and let the exemptions look after themselves. We have been told that we failed at Suvla Bay for want of ruthlessness; our commanders were too busy measuring the sacrifices to be incurred. It is to be hoped that our financial authorities will not have to make similar lamentations when it is too late. There has not been so far much of the ruthlessness of war about our economy.

CHAPTER XXVIII

THE TURN OF THE TIDE IN PUBLIC EXTRAVAGANCE

(*February* 19, 1916)

EVERYONE knows how difficult it is to find out if the tide has really begun to ebb, especially in rough weather. The watched tide seems never to turn back, and some seventh wave beats all the former water-marks. At various times since the outbreak of the war we have been assured that the tide of public extravagance has begun to turn, but hitherto, after a short interval, all the old marks have been washed out.

In this country one of the best signs of the advance of public extravagance has been the continued rise in prices. The proximate cause of the rise in prices has been the enormous expenditure of public money. Before the war the central government had about two hundred millions to spend in the year. Most of it had to be spent to meet former obligations: the charges for debt and for the public services. The amount of new money at the disposal of the Government for a new fiscal year was what we should now call a flea-bite, a mere flea-bite, or a contemptible flea-bite, or some adjective of that sort. We have got into the very bad habit of thinking in millions. A million pounds, we say, would not keep our part of the war going for six hours. What is the use of saving a million? We are in for a war of three years or longer. By this method of calculation the closure of the museums will keep the war going perhaps a quarter of an hour.

From the very beginning of the war the Government has been called on to help all kinds of things that in peace-time

had to rely on self-help. The latest demand is for public money to build merchant ships in order to bring down the freights,—a specially interesting and irritating flea-bite.

On the outbreak of the war the Government, which had been used in peace-time to spend on routine lines, and had not a beggarly million to do as it liked with, was suddenly given a free hand with hundreds of millions, and in the course of the war the hundreds became thousands. Long ago Mr. Gladstone said: "Good finance consists more in the spending than in the collecting of revenue." How much more, then, must good finance consist in the spending of loans rather than in the issue of the loans. In the course of a few months we had to provide for a Continental army of our own, and to assist in providing for several other armies of our Allies. The providing was done, for the most part, in the first place by spending huge sums of money in this country. Naturally prices rose. Naturally the receivers of the new money spent it. They spent most of it in increasing their consumption. There broke out what the leading English newspaper is wont to call an orgy of extravagance.

There is no need to go into the mysteries of currency and high finance to understand how the rise in prices is one of the best signs of the growth of public extravagance. In any case, everybody of any importance had forgotten all about the principles of currency. Perhaps forgotten is the wrong word. They were too busy with practice to look into principles. The money was found, the money was spent, and the prices rose. And, as Spinoza said, when a thing is once done, nothing is more foolish than repentance.

On the present occasion, however, the business is not to account for the height of the tide, but to look at the marks and see if the ebb has begun. The first mark is not very encouraging. The index number of the *Economist* is the best known device for measuring movements in average prices. The index number for last January has surpassed all records. It is higher than it has ever been since it was first calculated by Newmarch in 1850. "Our index number this month is the most sensational record in the whole

history of modern prices." Such is the editorial comment. Actually the index number was 174·5 compared with the basic 100 of 1901–05. Of course index numbers, like other statistics, are to be used with caution, but the evidence of high prices and the connection of the high prices with extravagance is too strong to be denied. A record index number from the middle of last century is a notable high-water mark. It is rather disquieting also that the rise in the month was greater than in any month since the beginning of the war.

So far the search for the turn of the tide is not very encouraging. And the worst of it is that the rise in prices is not only a sign in our case of national extravagance, but is a sign also of other national troubles. One of the forgotten principles of the old political economy was that a general rise in prices in any country tended to encourage imports and to check exports. The consequence of the combined operation was an adverse balance of trade. Economic principles do not cease to be valid because they are forgotten, and this particular bit of old learning has been abundantly verified by our foreign trade statistics during the course of the war. Imports are still rising and far above the records of peace, whilst exports are far below, and any expansion is very sluggish. There is nothing new in our having an excess of imports over exports. What is new is the amount of the excess and the way in which it is paid for. Before the war we were paying for the deficit in material exports by "invisible" exports. We were not only paying in this way for all the extra imports, but we were continually adding to our investments of capital abroad. It is said that before the war these investments amounted to about four thousand millions. We are now paying for our excess of imports by the sale of securities abroad or by incurring debts wherever we can get credit.

The adverse trade balance, and the mode of meeting it, are viewed by the British public and their advisers with apparent equanimity for two reasons, both of them fallacious. One is that the adverse balance seems a flea-bite in the face

of the four thousand millions we have to draw upon. It is forgotten that for the present we are selling the cream of our foreign securities. When we come to the second and the lower classes, how much will America absorb, and at what prices? The other reason for the popular indifference to the dangerous excess of imports is due to the survival of the old Free Trade maxim that if you take care of the imports the exports will take care of themselves. It is forgotten that the foundation of this comfortable belief is the more vital maxim that if the imports are not paid for they will cease. In the meantime we are living so far on our capital.

There is yet another reason for the popular indifference to the excess of imports, a reason which is valid up to a point, but dangerous when carried too far. This is the belief in the unlimited power of British credit. British credit, like other kinds of credit, must rest on real foundations. It is not merely a matter of sentiment or prestige. The result of the search for credit in the United States last autumn by the Government and the bankers was not encouraging. On balance we are certainly providing more credit for our Allies than we are receiving from benevolent neutrals.

It is not only the amount of the adverse trade balance that is or ought to be disquieting, but the quality of it. In the first place, there is an important omission. In the Board of Trade returns no account is taken of imports on Government account for the purposes of the war. How much that may amount to perhaps no one knows accurately, but Sir George Paish, who has been closely associated with the Treasury, stated in his recent optimistic discourse to the London School of Economics that the sum was 145 millions a year. The residual truth remains that a good deal of the adverse balance is due to luxuries. It is often hard to draw the line between luxuries and necessaries. But it is not so hard when a nation is engaged in a great war. In war-time we may class as luxuries all the things that are not needed, directly or indirectly, for the conduct of the

war. The term "indirectly" no doubt brings in a good deal of laxity, such as is suggested by the pernicious byword "business as usual." But, on the other hand, the conduct of the war is a very healthy saving clause. It reminds us that in many cases the distinction between luxuries and necessaries is not one of kind but of degree only. Grain and sugar may be made into intoxicants, and tea into indigestion, although the initial pleasures and the final ailments may be very unevenly distributed amongst the people. Here another of the musty truths of the old economists forces its unpleasantness on the attention. All the consumption of the productive labourer is not productive consumption, but only that part that maintains or increases his productive power. The conclusion of this part of the matter is that the adverse balance which is beginning to alarm the Government is not necessary for the conduct of the war, and might be reduced to the great advantage, moral and physical, of the people.

But although when we look at the records of rising prices and adverse trade balances the tide of extravagance seems to be still running strong, there are some little pebbles and footprints at the extreme verge of the water-mark that seem to indicate that the tide is beginning to turn. The Prime Minister has declared that a million is not a flea-bite, and that every penny counts. The voice is the voice of Gladstone. It is to be hoped that the chorus of approval will be such as it used to be. There can be no question that, as Gladstone once said on a famous occasion, the great cause of the growth of public expenditure is the growth of the spirit of extravagance. In the present war the spirit of extravagance, which had been growing rapidly in peace, instead of being retarded, as it ought to have been, received most stimulating encouragement. Money fell from the air like manna, and all the people said, "It is manna," and they remembered that Moses had said, "Let no man leave of it till the morning." And they spent the money or ate it, and said they felt the better of it. But they forgot that the age of miracles is past. The Prime Minister has reminded

them that a pound is made up of pennies. The people must begin to think, not in millions of pounds, but with the two hundred and fortieth part of a pound as their unit. Instead of saying that a saving of £50,000 on museums would only keep the war going (and only the British part of it) for a quarter of an hour, let them consider rather that if a British soldier costs £150 a year, the despised £50,000 would keep 333 soldiers for a year. Instead of talking of silver bullets, let us talk of the real thing. The poorest can give enough to buy a real bullet. A real bullet ought not to cost much more than a penny flag, and any one bullet might account for a German.

People who are anxious to follow the advice of the Prime Minister, and save a penny for the Chancellor of the Exchequer, and do not know how so small a sum can reach so great a money dealer, may resort to a very simple and effective method. It is the penny flag method, without its abuses. Anyone who wishes to give a penny to the State, and is content not to make a public display of his charity, has only to take a new postage stamp and burn it. The burning of the stamp is a sure way of paying a penny (less the negligible cost of the stamp) to the State. The recent increase in postal charges is the compulsory form of the voluntary offering proposed.

There are other small signs of the turn of the tide. It is rumoured that all the M.P.'s who have no use for their official salary will be relieved of the popular odium attached to its acceptance. The Retrenchment Committee has resumed its labours, and a new committee has been appointed to preach thrift to the people. The device of burning postage stamps is respectfully suggested as a unique combination of extravagance and saving.

One of the most hopeful of all the signs of the turn of the tide is the fact that from the end of last year the aggregate amount of the Treasury one pound and ten shilling notes has begun to contract. With the New Year the authority which manages this part of the business of war made a good resolution. The new paper money had surpassed the

hundred millions, and it seemed to him enough. The good resolution was to add no more, or even to contract the old issues. For the four weeks in January the good resolution was kept. The outstanding amount was actually diminished by about five millions. The last week of the month the resolution was a little sickly, and the rate of reduction was lessened. The next week there was a severe relapse and the issues again increased, but the authority pulled himself together, and by the last return the good resolution is doing well.

As often explained in the course of these papers, in the opinion of the writer the general rise of prices in this country is partly due to the over-issue of paper money and the consequent relaxation of the checks, which in normal times are imposed on the undue inflation of bankers' credit.

Before the war the average amount of Bank of England notes in circulation was less than thirty millions. At the end of last year it is true that this amount had only been increased by some five millions. But in addition there had been issued more than a hundred millions of the new Treasury notes. That is more than £2 per head of population, and is pretty well for a country that boasts that its currency is the cheque. In France, where the cheque system is little developed, the notes have been a little more than doubled, whilst with us the increase has been over threefold.

Our bankers turn longing eyes to the stores of gold held by France. If only they could get fifty millions as required to help the American exchange how happy they would be —for the time. But how long would the relief last if the present rate of importation is to continue? Let us be just. Our adverse trade balance is due largely to our own extravagance. On the other hand, the additions made by France to her gold reserves have been collected from the people, and special gold certificates given in return.

Fortunately, it seems as if this high tide of extravagance

had begun to turn. It is to be hoped that the little signs will be followed by greater and more certain evidences. The coming Budget will be looked for with the expectation that a real check will be placed on the extravagance of the national consumption.

CHAPTER XXIX

THE BUDGET

(*April* 12, 1916)

"With all its imperfections we may perhaps say of it what was said of the laws of Solon, that though not the best in itself, it is the best which the interests, prejudices, and temper of the times would admit of. It may perhaps in due time prepare the way for a better." Such was the comment made by Adam Smith on the system of Corn Laws established by a statute passed some three years before the publication of the "Wealth of Nations." Adam Smith's opinions of questions of economic policy—even on Corn Laws—were never purely theoretical, but were always revised in the light of historical development and the circumstances of the time. The praise and the hope of the sentence quoted may be transferred to the present Budget, and the speech with which it was introduced. The interests, prejudices, and temper of the times have forced the Chancellor of the Exchequer to leave undone some of the things which he ought to have done or might have done. But the Budget as it stands has very great merits, and so had the speech. The speech was a model of lucidity and of brevity. The arithmetical peroration was far more forcible than the resounding eloquence of which Mr. Gladstone set the fashion. "We are raising £300,000,000 in the present year by new taxation imposed since the war, while Dr. Helfferich announces a doubtful increase of £24,000,000." From the artistic point of view the peroration should have ended with the paltry twenty-four millions of the Germans. The praise of our civic courage is not so convincing. Records in drinking and amusements, excess profits and strikes,

extravagance and fictitious prosperity, are more suggestive of business as usual than of civic courage. In persons and in places, no doubt, from the highest to the lowest, there have been evidences of civic courage, but the fact remains that hitherto the masses of the people have not felt the real burden of war, and that too many of the classes have made greater fortunes or made higher incomes than they could ever have obtained but for the war.

To return to the arithmetic; the Budget has great merits. There are many rules of taxation which it is well to observe, but in time of war they must all give way to the great rule of productiveness. Mr. McKenna's taxes are all productive as they stand, and it is to be hoped they will not be whittled down in deference to interested objections. It is true that the first of Adam Smith's rules for taxation is equality, and by equality we mean justice as between classes and between the members of any class. In the new Budget equality is not altogether neglected. It would be well if, with due regard to productiveness, still greater equality could be attained.

In the income tax—and in the main the Budget is an income-tax Budget—there is a rough progression. If the progression were less rough, it would be more equitable, and probably more productive. A parliamentary paper has been issued giving some illustrative figures. Here is an example. A person with £1,000 a year earned income pays at the rate of 2*s.* 6*d.* per pound—*i.e.*, £125. A person with an income of £1,001 a year of earned income pays at the rate of 3*s.* per pound—*i.e.*, £150 3*s.* That is to say, if a man earns one pound more he has to pay twenty-five pounds more tax. A difference of twenty-five pounds on practically the same income seems absurdly unequal. Who would be so foolish as to earn the extra pound, or twenty-five pounds, or if he earned it would not do his best to evade the tax? A continuous progression such as is adopted in some of the Australian land taxes would get rid of such glaring anomalies.

The history of the British income tax and the changes

in public opinion regarding it are instructive. During part of the Napoleonic wars the income tax was submitted to as a war tax, but it was probably the most unpopular of all the taxes. As soon as peace was declared there was an outcry, led by the City of London, for the repeal of the tax. The Government wished for its continuance, but were defeated, and "the result was declared amidst the greatest cheering and the loudest exultation ever witnessed in the English Senate." Lord Brougham thereupon moved that all the records of the tax be destroyed, and the motion was adopted by an overwhelming majority. The tax was renewed with reluctance by Peel in 1842, and was strengthened by Gladstone in 1853. By way of apology he delivered a speech about five hours in length, of which the part that has become immortal is his declaration that "in my individual opinion it is perfectly plain from the mode in which it was put an end to at the termination of the great war that it is not adapted for a permanent portion of your fiscal system unless you can remove what are called its inequalities. Even, however, if you could remove its inequalities there would still remain, in my mind at least, objections of the gravest character." As everyone knows, the income tax was continued by Gladstone himself, and since his day has been increased, until at present it is by far the most important part of our tax system. Coincidently with this growth of the tax and of its yield there has been a corresponding change in public opinion in its favour.

This great change in public opinion has been mainly due to the removal of some of the inequalities and of some of the other objections which Gladstone had in mind. Next to the inequalities the greatest of the objections was the power of evasion. Taxation at the source and other devices have lessened the evasion in normal times, and the rise in the limit of exemption with the introduction of progression and differentiation have lessened apparent inequalities of sacrifice. But the enormous rise since the war has emphasised the inequalities that remain, and introduced others. Judging by the experience of the past in our own and in

all other countries, a tax that can be evaded will be evaded, and the higher the tax the greater the desire to evade. If all the excess profits of the war are really subjected to their full taxation according to law, we shall have the greatest example on record of civic courage and the power of conscience.

If, as seems probable, the income tax must perforce remain at a very high rate for long after the conclusion of the war, it is highly desirable that as far as possible it should be freed from new inequalities and new incitements to evasion.

When we look to the distribution of the new taxation between different classes of the community—especially as between the income tax-payers and the others—there is not much observance of the rule of equality except in the breach. The increase in indirect taxation has not yet been sufficient to check the extravagance of which such complaints have been made, and the new taxes are limited both in extent and in degree. Hitherto the rise in the price of sugar has had practically no effect on consumption, and the new taxes on sugar, chocolate, and the like will probably have no more effect if the rise in wages continues.

For "the willingness displayed by our citizens as a whole to submit to the exactions of the tax-gatherer" Mr. McKenna said he could find no parallel. So far as the masses of the people are concerned, the willingness has not been very severely tested, and the proposed railway tax is already resented in the interests of labour. The payment of war bonuses in war bonds was long ago suggested, but the willingness of the workers to submit to this mildest of all forms of taxation—if deferred payment with the best security in the world and 5 per cent. interest can be called taxation—was not tested. The prejudices of the times do not admit of so great an interference with the liberty of labour to do as it likes with its own property.

The consequences of this reluctance to impose taxes on the non-payers of income tax will only be fully realised at the end of the war. In many games and in most businesses

a stroke must be judged, not only by itself, but by the position it leaves. Considered as an emergency Budget, the present Budget is a success in raising a great revenue for immediate needs. But what about the general position that it leaves? Can the present taxes be continued after the war? How can a tax of 5*s*. in the pound on so-called unearned incomes be retained when the restrictions on foreign investment are removed? Such a heavy tax will not only encourage the export of capital, but also hinder its accumulation. The super-taxes will have similar effects. Heavy taxes on earned incomes are sure to react on productive power, and, as earned and unearned incomes are inseparably blended in practice, to react also on capital. The merchant, said Adam Smith, is a citizen of no particular country. A very trifling disgust will make him move his capital from one country to another. The present income tax on the higher incomes, if continued after the war, will be reckoned as more than a trifling disgust.

"An old tax is no tax" is one of the wisest of financial maxims. But it never applies to the income tax. The income tax is always felt, and whatever adjustments may be made the tax comes out of the income that is left. Taxes on commodities or on services in the course of time become part of the customary price. The man who drinks a glass of beer has no idea how much of the price is tax. It is certain that the same revenue could not be obtained from the same people by any device of direct taxation.

It is often forgotten that the income tax-payer is also a payer of indirect taxes. To the ordinary professional man the extra income tax lops away his usual margin—even if his income has not fallen—and his household expenses increase with every tax on articles of general consumption. But even to the income tax-payer of this class after a point indirect taxation is less burdensome than another penny or another sixpence in the pound.

These considerations become of increasing importance when we look to the financial position that will be left on the conclusion of peace. Mr. McKenna gave a summary

of the position on the supposition that the war ended with the present financial year on March 31 next. The statement is admirably clear, but there is an omission which may easily be converted into a false suggestion of optimism. The suggestion is not warranted, but that is true of most suggestions.

After the war—(say) March 31, 1917—our peace expenditure is put down as £338,000,000. The yield of the present Budget, which is described in ominous terms as revenue of a possible permanent character, is given as £423,000,000. This will leave an apparent surplus of £85,000,000.

But consider how the post-war expenditure is calculated. The expenditure (apart from the charge for debt) is put at the same annual figure as before the war—namely, £173,000,000. Of this sum, according to the last estimates before the war, £77,000,000 were assigned for the Army and the Navy, including the non-effective charges. Our own net war expenditure (not counting advances to our Allies) for the present financial year is stated as £1,150,000,000, which is about fifteen times as much. In a world war such as this, even after the declaration of peace, it will be necessary to keep up large forces by way of insurance against a renewed outbreak or the non-fulfilment of the conditions. One of the greatest of the financial difficulties of the future will be the indisposition (to use no stronger term) to rely on German promises not backed by material guarantees. In the last resort the material guarantees can only be maintained by the military forces of the Allies, and this country, as the richest, must bear the lion's share of the charges. It seems quite obvious that, even if the war is ended next March, our next financial year will see this country still making large additions to its debt. The estimated surplus of £85,000,000 will certainly not suffice to meet the post-war military and naval charges for some time to come, and it is quite possible that with the new demands the old days of "bloated armaments" of £77,000,000 a year will never be restored.

The same result is arrived at if we consider the pre-war

civil expenditure. We have to take account of the rise in prices, and to take account also of the demands that will be made for greater Governmental interference and management. Are we not told that we can never revert to our former ideas of *laisser faire*, and that more and more Governmental organisation must be arranged for—and paid for?

The remainder of the £338,000,000 of estimated expenditure is made up of a total debt charge of £145,000,000 and £20,000,000 for pensions. The debt charge is reckoned on what is called our net debt, which is arrived at after a deduction of some £800,000,000 for advances to our Allies and Dominions. How much of this amount and how soon will be recoverable it is not possible to say, but it is quite clear that our own net charge will not be freed from this addition in the next financial year. Accordingly, just as the pre-war charge (less debt) of £177,000,000 is sure to be much exceeded, so also is the estimate of £165,000,000 for debt charge and pensions. The surplus of £85,000,000 will thus become a German kind of accounting surplus instead of a British real surplus.

The debt charge of £145,000,000 is said to include a substantial charge for sinking fund. It will be time enough to speak of sinking funds when the debt has ceased to grow, of which there is very little prospect for some time after the conclusion of peace.

One short paragraph of the Budget speech was devoted to the possibility of economies. The Chancellor of the Exchequer said that he would be disappointed if serious economies were not effected in the course of the year. He alluded to the admirable work of the Committee presided over by Mr. Long. But the hope was shattered in the next sentence: "On the other hand, we must not forget that there has been a material rise in prices, and the result of the economies may do no more than make up for the increased charge from this cause."

As often pointed out in these papers, the rise in prices is one of the principal contributory causes of our financial inconveniences. The adverse balance of trade, the extent

of the excess of war profits, the persistent recurrence of labour disputes, are all aggravated by the rise in prices. If there is any truth in the principles which were accepted both in theory and in practice in this country before the war, an inflation of the currency and of the credit based upon it is certain to lead to a rise in prices. As yet there is no indication of any contraction of the inflation. The effort of January—if it was an effort and not an accident—soon collapsed. Since the end of January the outstanding Treasury notes and certificates have been increased by nearly twelve millions, the greatest weekly increase being that for last week.

We are ready enough to admit the sequence of cause and effect in Germany. We think that in Germany the over-issue of paper money of all kinds raises prices, though in Germany the other great cause of rising prices—namely, scarcity—is operative. In our own case we are content to suppress the symptoms of a depreciating currency. We keep up the American exchange by the export of securities bought with public money. This last month our imports have increased by some ten millions over March of last year, and nineteen millions over March of 1914 (the exports being nine millions less).

In the current number of the *Economic Journal*, the quantitative theory of money is applied by a Swedish expert to the principal countries. After describing the difficulty of calculating the quantity of the circulating medium, he writes :—

"Nevertheless, it has been possible to prove that the advance in the general level of prices such as shows itself in the index numbers of Mr. Sauerbeck (continued by the *Statist*) is, broadly speaking, proportional to the increase of the circulating medium of the country, and thus that the enhancement of prices is essentially to be regarded as an expression of the inflation of money."

CHAPTER XXX

THE RATE OF INTEREST ON BRITISH WAR LOANS

(*May* 27, 1916)

"Unto thy brother thou shalt not lend upon usury."

About one hundred and fifty years ago Adam Smith observed that in Great Britain money was lent to the Government at 3 per cent. and to private people on good security at 4 or 4½ per cent. A difference in favour of British Governmental securities before the present war had come to be accepted as a kind of law of nature. The British Government could borrow at less rates than private people and at less rates than other Governments. At present a comparison of the rates of interest on British war borrowings seems to show that this difference in favour of the British Government has disappeared, or is fast disappearing.

Before the war the rate of interest at which a Government could borrow was commonly supposed to be the simplest and surest test of national credit. The rate was usually estimated by the yield on the purchase price of the stock that represented the chief form of the national debt. In this country the price of Consols was regarded as the national credit barometer. In the decade before the war one-half of the present Coalition Government (the new half) was criticising the other half (the old half) for the fall in the price of Consols. It is true, whatever may have been the causes, that the differential rate in favour of British Governmental securities was not so great as it had been in former decades, but it was still there, and tried by this test British Governmental credit still led the field.

What are the facts at the present time? The Government is advertising in all possible ways its Exchequer bonds

bearing 5 per cent. interest and redeemable in December, 1920. The lure is adapted to the banker, who does not look at a less unit than a thousand pounds, and to the working man, who is invited to invest 15*s*. 6*d*., which will grow into a nice Christmas-box of a pound in 1920. In brief, anyone can lend to the British Government as much as he likes at 5 per cent. for five years. As an additional inducement the holders of the bonds are promised that in case a long period loan is issued at a higher rate of interest, they can transfer into the new loan without loss and without the provision of any "new money." That is to say, the Government is not only borrowing at 5 per cent. actual, but is giving a conditional promise to raise the rate in the future. Besides borrowing by bonds, the Government is also borrowing in the same unlimited way by means of Treasury bills for a year and lesser periods. The rate of interest in the case of the yearly bills works out at about $5\frac{1}{4}$ per cent. on the money received. There are also certain advantages in calculating income tax which make the bills a better investment for the lenders and a more costly mode of borrowing for the Government, but in practice the bills are not available to the ordinary investor.

The foreign investor in our Exchequer bonds is freed from any payment of income tax or any other tax, present or future. The loan placed in the United States for exchange purposes was on a 6 per cent. basis (also with certain privileges).

But leaving out of account any privileges, and taking the rate paid by the State at 5 per cent. only, how does this rate compare with other rates in the home country? The Scottish banks are paying only 3 per cent. on deposits. Of course, the right of withdrawal at any time of the principal without depreciation has a market value, but it seems surprising that any ordinary investor should leave his money with a bank at 3 per cent. rather than with the Government at 5 per cent. if the principal is to be repaid in five years. The proper comparison, however, is not with bank deposits, but with money lent on mortgage or deben-

tures and the like. In the advertising columns of the newspapers we see mortgage companies, local corporations, boards, and trusts of various kinds offering to take money at 5 per cent. for five years, with lesser rates for shorter periods. In these cases there are no contingent promises to pay higher rates, and there is no appeal to patriotism.

The comparison with other Governments is not much more satisfactory. Naturally, one would have supposed that in a world war the comparative rate of interest paid by the British Government would have been still more in its favour than in times of peace. Relatively, the security offered by the British Government seems much greater than in the case of any other of the belligerents. But if we look at the rates of the war loans of the other States, we find that Germany has issued its loans at 5 per cent., and even Russia has issued internal loans at 5 per cent.

The method of borrowing for short periods has its conveniences, but it also has its dangers. The borrowings of a Government in a great and prolonged war are always in reality long-period borrowings. In the so-called short-period method (or the method of continuous borrowing, as it has come to be called by its advocates) the moneys borrowed must be continuously repaid. Failing surplus revenue from taxation, they can only be repaid by fresh borrowings. There will certainly be no real surplus revenue at the end of next year, and probably not at the end of five years. In December, 1920, it is extremely unlikely that even one hundred millions will be available from taxation to pay off the short-term Exchequer bonds. Of course, the security is perfect, but the bonds can only be repaid out of fresh borrowings. The Treasury bills, already exceeding £600,000,000, must, of course, be renewed from time to time as they fall due.

The method of short-term borrowing cannot be extended indefinitely, and some time a new big long-period loan must be floated. Already we are told that it must have new attractive features, which, being interpreted, means that, directly or indirectly, the Government must be asked to

pay more than they have hitherto offered for a permanent loan.

What, then, is the conclusion? Are we to say that the credit of the British Government is no better than that of a common investment company? No better than that of the German Government? After all the fanfares of our trumpeters and the resounding thumps of our drummers, are we to confess that we are to be put with the common herd of Governments, and pay more than 5 per cent. to the home investor, and more than 6 per cent. to the American lender (if any)?

Fortunately, there is an alternative explanation. It is not altogether flattering to our business methods, but it is preferable to the other: the explanation—namely, that the British Government has paid higher rates of interest than it ought to have paid. Instead of following the rise at its usual respectable distance, Governmental borrowing has led the rise in the rate of interest, and other first-class borrowers have come lumbering after. As a natural consequence, the capital value of all first-class securities has depreciated, much to the inconvenience of financial institutions, which are large holders.

This depreciation (or the fear of it) and the desire to provide a remedy (or prevent it) has induced the Government, in addition to the actual interest, to offer those other inducements, which are perhaps best described as war bonuses. When the Government issued its first loan, for what now seems to be the small amount of 350 million pounds, the nominal rate of interest was, indeed, only 3½ per cent. But the price of issue was 95, and practically the loan was on a 4 per cent. basis. In addition to the interest there was offered a most extraordinary bonus. The Bank of England guaranteed for a period of three years to lend on this security at 1 per cent. below Bank rate up to the value of the price of issue. As a rule a common bank will only lend with a good margin, but here we find the premier Bank of the world actually lending more than the value of the security at 1 per cent. below its own minimum. The fact would seem

incredible—one would suppose there was some unofficial way of evading so odd a bonus—but the recent bankruptcy of a noble Duke showed that the privilege had been used for a good-sized speculation, his share in the gain being put at ten thousand pounds. No doubt the underlying idea in this bonus was that the privilege would prevent the depreciation of the stock, and it was never imagined that the price of the stock could fall, as it has done, to 87.

In the next long-period loan the nominal rate of interest was $4\frac{1}{2}$ per cent., but there was the extraordinary proviso that if any new long-period loan was issued at a higher rate the old stock would automatically receive the benefit of the rise. In that way it was supposed that this stock could never be depreciated. The idea was that as soon as any depreciation was threatened, the Government would have to borrow at a higher rate, and the rise in the rate would check the depreciation. This argument was supported by another, which, indeed, was ostensibly the chief argument—namely, that no one would have any reason to wait and see if the next loan would give a better rate.

Not only was the attempt made to provide against the depreciation of the new $4\frac{1}{2}$ per cent. loan, but provision was also made for reducing the depreciation already incurred in the old Governmental loans. Holders of these old securities (Consols, $3\frac{1}{2}$ per cent. War Loan, etc.) were enabled to convert their holdings into the new loan (with its new privilege) if they provided a certain amount of "new money." On balance there was a considerable gain to the converters, and a corresponding increase in the debt charge to the State.

As already pointed out, the Government is now borrowing by the continuous method at 5 per cent. (or more). Judging by the progressive rise of the rate of interest in the past, we may expect the next long-period loan to be issued at a still higher rate, directly or indirectly. The new attractive feature that is being asked for is a partial exemption from income tax. The collection of the full 5*s*. income tax at the source is certainly troublesome, inequitable, expensive,

and deterrent. On the other hand, any remission means that the Government has to pay so much higher rates on its borrowings.

In the meantime the incubus of the automatic rise on the $4\frac{1}{2}$ per cent. long-period loan has given great encouragement to the short term or continuous method. But if the war is prolonged and new long-period loans become inevitable the automatic rise in the rate of interest, which applies also to the 5 per cent. bonds, becomes expensive. If we allow for the automatic incubus a new long-period 6 per cent. may involve extra incubus payments which will make the real rate on the new money 7 per cent. or more, according to the size of the old loans. If the policy of the automatic rise is continued, and if every new loan at a higher rate must drag up all its sinking older brothers, the arithmetic becomes worse than expensive—it becomes absurd.

What, then, is the practical conclusion? The only use of criticism in war-time is to lead to improvement in the future. It is perhaps too late to go back on the 5 per cent. which has already become the Governmental effective rate, and if a new loan is issued at any higher rate, then also the automatic rise must be submitted to. But it is never too late to apply the principle of limitation. It is a mistake to suppose that a rise in the rate of interest is necessary with every new loan. Five per cent. on internal loans issued by the British Government ought to be the maximum in the strict sense, and ought not to be exceeded by bonuses of any kind, direct or indirect. If people were made to understand that under no circumstance would the Government offer more than 5 per cent. on its internal loans there would be no hanging back in the hope of better terms. The automatic incubus would cease to grow, and the decision between short-term and long-term borrowing could be taken on its merits. With £600,000,000 of Treasury bills outstanding (not to mention the bonds), the time for deliberation seems to have come.

But it may be rejoined: Suppose that 5 per cent. will not draw out the money? Suppose that the people prefer

3 per cent. on deposit receipt or 10 per cent. on good rubbers or breweries? Or suppose that they put the money in business and trade? What is the Government to do then? The answer is to be found in the blessed word "compulsion." Long ago Mr. Bonar Law warned the public that if they did not subscribe to the voluntary war loans they would be compelled to subscribe to a forced loan. There ought to be no difficulty in the admission of the principle. In the face of compulsion on life the objection to the compulsion on money is negligible. It is to be observed also that from the very beginning of the war the method of the forced loan was adopted in an indirect or concealed manner. The restrictions on other investments by the Treasury forced money into the Governmental channels. The fixation of minimum prices on trustee securities meant that the yield on the price was a forced low yield. At the same time, the higher rate of interest paid by the Government made these old securities unsaleable at their minimum prices. Limitations have also been imposed on business profits either by regulation or taxation, and the general opinion is that this principle of limitation has not yet been applied with sufficient stringency. It might well be extended.

In matters of principle, and especially in cases that concern freedom of contract, the opinion of Adam Smith is always to be considered, because no man ever maintained so fully and so sanely the principle of natural liberty. But this same Adam Smith approved of a legal maximum of the rate of interest even in peace times. He considered 5 per cent. a fair legal maximum in his day. We have given up the idea of a legal maximum in peace time—no doubt with advantage—but in war we are constantly thrown back on the methods of earlier times. War in a sense is a reversion to economic barbarism—or, let us say, to lower stages of economic development.

A forced loan is by no means so horrible as it may appear at first sight. To compel a patriot to save £100, and accept 5 per cent. interest for lending it to the State, is not a very oppressive kind of compulsion. Many a professional man

who managed to put away (say) £100 in the year now finds that the income tax on the top of other war charges absorbs all the £100. In this case the State may be said to take from him a forced loan, on which it pays no interest and of which it never repays the principal. There is no difficulty about the morality of a forced loan in war-time, or of a limitation of the interest to be paid by the State to a reasonable figure. The real difficulty is in the practical methods by which the plan may be realised. A short time ago the bankers and great financiers issued a manifesto on the need for economy on the part of people in general. They did not mention the economy in the interest to be paid on war loans. Now is their opportunity.

CHAPTER XXXI

THE PARIS ECONOMIC CONFERENCE

(*July* 1, 1916)

During the course of the war occasional echoes have been heard of the fiscal controversy that shook the country ten years ago, and was the dominant issue of a General Election. In general, however, it has been recognised that a state of war ought to be a state of silence on party issues. Ministers of the Coalition have pushed the self-denying ordinance to an extreme. When the exigencies of the war made a check on imports desirable, Ministers of both complexions were careful to explain that there was no question of any change of principle. The restraints on imports were war measures pure and simple. The explanation seemed so reasonable that most people were surprised at the mildness of the war measures actually adopted.

The recommendations of the Paris Economic Conference raise issues which cannot be passed over so lightly. They involve a full consideration of the principles which are to guide the policy of the Allies, not only during the period of the war, but also in the period of reconstruction after the war and in the more remote future, when, to put it in the concrete, the Kaiser is as dead as Queen Anne.

It is much to be desired that, in the necessary discussion of principles, people should recognise that the old arguments for the most part need a readjustment of emphasis. The readjustment is as necessary for the pre-war Tariff Reformer as for the pre-war Free Trader. Such a readjustment of emphasis may be best accomplished by going back to Adam Smith. The greatest of Free Traders (as he was the greatest of economists) admitted in every part of the Free Trade system that on occasion the rule must yield to the exception.

The present war has shown that some of his recognised exceptions are now of vital importance. The most stalwart of Free Traders need not be ashamed to follow in the footsteps of his great master. At the same time, the most ardent of Tariff Reformers will find that the question of Customs duties or prohibitions is only one of the measures of mutual assistance and collaboration among the Allies taken account of in the report of the Conference. The truth is that the war has in part revealed and in part created conditions which render the pre-war modes of thought inappropriate. The war has revealed the extent and the nature of German penetration in the past, and made equally clear the kind of penetration that is contemplated for the future. But although the gravity of the German peril was the basis of the whole discussion at the Conference, it is doubtful if it is adequately realised by the people at large. And it never will be realised if it is supposed that the principal question is a question of Free Trade or Protection under ordinary peace conditions.

The text of the Conference report begins with the declaration that the Central Empires, after forcing upon the Allies a military contest in spite of all their efforts to maintain peace, are to-day preparing, in concert with their allies, for a contest on the economic plane which will not only survive the re-establishment of peace, but will at that moment attain its full scope and intensity. From the German point of view, it is now clear from varied evidence that the main cause of the outbreak and of the continuance of the war has been the hope of economic gain. Germany wanted an expansion of overseas colonies and an expansion through South-Eastern Europe into Asia. Apart from territorial expansion it was desired that the whole economic position should be strengthened. Long before the war the preparations had been made by what was called the method of peaceful penetration. We were surprised at the outbreak of war to find how far this penetration had extended even in this country; but in other countries and in other parts of the Empire this penetration had been much more exten-

sive and dangerous—dangerous in the most elementary sense of the word to national independence. In Russia the German influences were as dangerous to the ruling classes as vodka to the peasantry. The change of name from Petersburg to Petrograd was a sign of the national reaction against the Germanisation of Russia. The relative weakness of Russia until these last days is mainly to be ascribed to this Germanisation. In Italy the German influence was still greater and more pernicious. Even now Italy is not technically at war with Germany, and the delay in joining the Allies, in spite of the popular determination, has made the task of Italy doubly hard. Even in the United States in recent years attempts have been made to check the natural assimilation of the German immigrants and to make their adopted country of secondary importance as regards political obligation.

This part of the case cannot be too strongly pressed upon the British public. They must be brought to understand the extent and meaning of the peaceful German penetration before the war. At first too much attention was directed to the ideas of the militarism of the ruling caste and of the anti-religious German philosophy. The relapse of Germany into barbarism in its military methods and its treatment of conquered countries could not fail to seize the popular imagination. Criminology is always more popular than political economy. A book of celebrated murder trials is always more interesting than a history of commercial crises. Peace has her victories no less than war, but the victories of peace are only realised with difficulty and at long intervals. And so also are the defeats. We have been slow to realise both the triumphs of German organisation and the disasters of German peaceful penetration. The foundation of the recommendations of the Paris Conference is the recognition of the dangers of German peaceful methods. The dangers of the future can only be avoided by realising the dangers of the past. The Government should take care that the people are well informed on the real meaning of German peaceful penetration.

The proposals of the Conference, as already indicated, are introduced by a reference to the preparations by the Central Empires for an economic contest immediately on the declaration of peace. Already in this country the question is being asked by the supporters of our traditional *laisser faire*: Where is the evidence? It surely cannot be expected that Germany should publish in the middle of the war its particular plans for the economic contest in official papers. But there is abundance of material in current German literature to show that the economic contest is to be more determined than before the war. The best presentation of the German case is given in the book on Central Europe by Herr Friedrich Naumann (see Part I., Chap. VIII., p. 130). It is to be hoped that the translation will be as widely read as the famous "J'accuse." Herr Naumann writes with great restraint. Of hatred against England there is not a word. On the contrary, there is more often outspoken admiration of English political methods in dealing with dependent nations. Germany, he thinks, must rely more on the consent of the governed and less on military force. He admits that the Germans are disliked all the world over. He accounts for this universal dislike partly by envy—the envy of other nations of German organisation. Perhaps disgust with German penetration would be a truer description of this part of the emotion. But also Herr Naumann admits that there has been too much of stamping everything with the Prussian stamp and the Prussian heel—too much despotism and too little freedom. The German, he says, must imitate the Briton in the arts of conciliation and toleration of diversity. The advice is good, and it seems simple—as good and as simple as telling a sinner to get his soul saved. Herr Naumann, it is stated, was once a pastor. He must have been a very delightful minister. In the middle of the war, in the middle of Germany, he has written a most popular book, without a sentence to which any censor in the wide world could object, though it is surprising that some of it has been passed in Germany itself. But there is a good deal of golden silence just at the danger-

points, and a good deal of commendation of the Kaiser at fitting moments. There is in particular one Wagnerian passage of such glory that the Kaiser himself might be expected to put it to music.

Such being the pleasant character of the book, what is the real argument? What are the basic ideas which have given it such a vogue in Germany in spite of the pro-Briton flavour? The answer is that the book displays, in the most solid argumentative, fateful manner the nature of the coming economic contest.

Germany, on this view, is not strong enough even economically to stand alone. Germany and Austria-Hungary must be fused into a super-State, able to stand against the other three great world super-States, Greater Britain, Russia, and the United States. The union with Austria and Hungary is to be the foundation of the new Central Europe. The absorption of the neighbours that are suitable will come in due course—first the Balkan States and Turkey, to be followed, it is to be hoped, after sufficient penetration, by Italy, and shortly the rest of Europe with the exception of Russia. But to begin with, the Central Empires after the war are to achieve a super-State economic and military solidarity.

In spite of the pleasantness of the literary dress, there is no concealment of the belief that the present war will be the forerunner of still greater wars. And in these greater wars the economic structure and strength will be of vital importance. If anyone wishes to get a preliminary idea of the kind of economic contest against which the Paris Conference sought to provide, let him look at the substance of Herr Naumann's argument. This argument may be taken as giving the minimum of the effort at reorganisation that is to be made. Even a smashing military victory on our part cannot in itself prevent the development of a Central European organism of greater economic power than Germany at the outbreak of the war.

It is interesting to observe that in the building up of this new Central Europe the question of tariffs is looked on as

of minor importance. Although the key to the situation is the closest possible economic union of Germany with Austria-Hungary (associated with equally close military union), the idea of a uniform Customs union and inter-State Free Trade is not regarded as either advantageous or possible. It is recognised that in some ways the other two countries will need protection of their industries against the greater technical power of Germany, and that foreign trade with the neighbouring Balkan States must not be left to unregulated competition. Austria and Hungary are to get their share, not by natural competition, but by syndication with Germany. Much more reliance is placed on the method of combination than on the method of competition. The same ideas are also applied to labour. Organisation, not competition, is to be the basis of the new military economic super-State.

The Central Empires will no doubt try to construct a new scientific tariff against outsiders, but at the most the tariff is only one part of the machinery. The next time the economic preparation is to be much more complete before the military attack is launched.

Reference has been made to the book by Herr Naumann not only because in itself it is an outstanding work, but because it is representative of a large body of Central European opinion. Already before the end of 1914 the economic bodies in the Central Empires that correspond to our Chambers of Commerce were discussing after-the-war commercial policy. In a meeting at Budapest in December, 1914, the result of the discussion was summed up by the president in the statement that the experience and the teaching of the war, and the political situation arising therefrom, as well as the reciprocal economic interests of the countries concerned, demand that the Monarchy and Germany should strive for closer economic union, and make their preparations in good time. Such a closer union, it was said, would naturally be made without the sacrifice on either side of economic independence as regards trade. The point is that to a great extent Germany, Austria, and

Hungary are to retain their control of their tariffs, both as regards their mutual relations and as regards foreign nations, but the economic union and development is to be promoted in other ways.

The Paris Conference is the recognition by the Allies of the fact that, whatever the result of the war, the Central Empires will at once set to work to strengthen the economic foundations of their military power. The Central Empires will not be turned aside from their main idea by over-rating the difficulties of adjusting tariff relations amongst themselves. In this respect the Allies must follow their example. They are combined in a great war of defence. One essential part of their power is their relative economic strength. If the Central Empires take thought to add to their economic strength the Allies must follow suit. The key to the Paris policy, as shown in the recommendations, is defence against aggression. The nature of the defence must depend on the nature of the aggression. The greatest obstacle to peace is the fear of the peaceful methods of Germany. If the people of this country are forced to go back in the direction of mediæval restrictions, the reason is that Germany has led the way. There was a time in England when foreign merchants were only allowed to come to the country for four great fairs. Later on, greater freedom was allowed—but their stay was limited to forty days. Gradually the restrictions were broken down, but even when permanent residence was permitted, there were restraints of various kinds affecting property and personal liberty. How far we may be compelled to go back in our reimposition of restraints will depend on how far the Germans advance with their new morality. What the Germans look on as progress in morality we look on as retrogression.

Let the anxious Free Trader and the anxious supporter of our greater freedom of larger political ideas read a lesson or two from the great apostle of freedom. "The very bad policy of one country," says Adam Smith, "may render it dangerous and imprudent to establish what would otherwise be the best policy in another." The lesson that the wealth

of neighbouring nations is certainly advantageous in trade—one of the lessons that did most to break down the old beggar-my-neighbour commercial policy of Europe—is introduced with a remarkable qualification—the wealth of neighbouring nations, says the teacher, "though dangerous in war and politics." A little lower down we find the provocative expression—it was applied to France and England—"being neighbours they are necessarily enemies." Everybody by this time knows that "defence is of more importance than opulence." But everyone does not remember the context:—

"When the Act of Navigation was made, though England and Holland were not actually at war, the most violent animosity existed between the two nations. . . . National animosity at that particular time aimed at the very same object which the most deliberate wisdom would have recommended the diminution of the naval power of Holland, the only naval power that could endanger the security of England."

The times have changed and we also. We are good friends with Holland and brothers with France. We are enemies of Germany, and even if not actually at war we shall continue to be enemies so long as Germany's ideas of peace are centred in the methods of peaceful penetration which led up to the present war. The Paris Conference is the beginning of the new defence against the next war.

CHAPTER XXXII

GOVERNMENTAL BORROWING AND COMPULSION

(*August* 2, 1916)

In a former chapter * attention was called to the high rate of interest on British war borrowings and to the progressive rise in the rate. Since then there has been an advance of 1 per cent. in the principal form of borrowing—namely, Treasury bills. On the yearlings the discount rate is now 6 per cent., and the interest on the money obtained by the State is about $\frac{3}{8}$ per cent. more. The amount of Treasury bills outstanding is rapidly rising, and now stands at over £831,000,000.

Besides the Treasury bills there are other forms of borrowing for short periods, varying from two to five years. Five years is longer than one year, but in the matter of public debt it is a short period. This accumulation of a very large floating debt is now called the method of "continuous borrowing." The worst of continuous borrowing is that it means also continuous renewals, and if the rate of interest is rising renewals at an increasing cost.

The rise in the rate of interest on the floating debt reacts on the rate of interest on long-period loans, and a new long-period loan can only be issued at a higher rate. This higher rate must automatically be extended to the old loans. It is so nominated in the bond. The continuous system cannot go on for ever. A new long-period loan must be faced some time; the longer it is deferred the harder the conditions. What is to be done with this enormous floating debt at the end of the war? How is the recovery of trade to be financed? How are all the encouragements to industry and commerce

* See Part II., Chap. XXX., p. 371.

of which we hear so much to be paid for? Are we to go on borrowing for the reconstruction of peace?

These are very serious questions. Whatever answer is given, one thing ought to be absolutely clear—namely, that every economy ought to be made that does not impede the conduct of the war. But the experience of the last two years has shown that general appeals to economy are of little use unless by way of introduction to some practical expedient.

One of the economies not yet tried is an economy in the rate of interest on public borrowings. The practical expedient by which such an economy might be effected is compulsion. It may perhaps be thought that the present time is inopportune for the suggestion of compulsion, when a great national effort is being made to raise money by the voluntary War Savings Certificates. The recent increase in the sales of these certificates has been remarkable. In May the sales averaged about a quarter of a million a week. In the first week of July the amount had risen to nearly a quarter of a million a day. The latest report of the "boom" in War Certificates is that the daily sales have again doubled. The financial and moral results of these efforts are considerable. But they ought not to be exaggerated. A sale of half a million a day will only provide for one-tenth of the normal five millions. The other nine-tenths must be raised in other ways. And it must be remembered that this half a million a day of war savings is not presented to the State as a free-will gift—it is not like one of the great war charities. On the contrary, it is to be repaid at the end of five years with what in other cases would be called an "unearned increment" free of income tax of about one-third of the original advance, not to mention facilities for withdrawal without loss in the interval. The economy for the individual investor is excellent, but the economy for the State is not so excellent. To the State, indeed, the gain is supposed to be chiefly indirect, as is so well explained in the latest thrift poster.

From the moral point of view there may seem to the eye

of the philosopher more of prudence than of patriotism in so attractive an investment. "Breathes there a man with soul so dead" that he will not lend to his own native land 15*s.* 6*d.* for £1?

Surely our perfervid appeals to patriotism might have a more robust ending. Surely we might test our patriotism in the matter of money as we have tested it in the matter of life. Unfortunately, however, it is only in mathematics and not in politics that the greater includes the less. The people who howled for a forced levy of men will cry out that a forced loan of money will blast for ever the business character of the Government and of the people. The people who say that *laisser faire* is dead, that wages must be fixed and profits controlled, shrink with horror from Governmental interference with the rate of interest, although it is the oldest and the most respectable of all the Governmental interferences in history. The Government may pay a soldier one shilling a day instead of the market rate of (say) five shillings for his labour, and give him no option, but the Government must not discount its bills at 5 per cent. if the Bank rate is 6 per cent.

The revolutionary socialism suggested in this last sentence may be neutralised by another example. Very early in the war—when war bonuses on wages began to be rampant in the favoured industries—it was proposed that the bonuses should be paid in War Loan Certificates. Had this plan been adopted all the economic gains of the War Savings Certificates which are now so much extolled would have been multiplied a hundredfold. Extravagant consumption would have been checked, the balance of trade would have been improved, and the plenty of war would have been made to help the coming leanness of peace. What were the real obstacles to so beneficial a war economy? One real obstacle was that we tried to carry on in time of war with the economic ideas of property only adapted for times of peace. The working man had earned his bonuses—they had become his property—shall a man not do what he likes with his own? Does not the institution of private property itself rest on

the principle that every man has a right to dispose of the product of his labour? But the correct answer is no, not in war-time. In war-time the need of the State is the supreme law.

But perhaps a still greater objection to this excellent plan was found in the perversion of the principle of equality of sacrifice. Why should the working man be made to contribute to a forced loan and other classes be left free? Why should not all incomes be made to invest a certain proportion in War Loan? The answer of those interested was that other incomes were subject to a progressive income tax, and that excess war profits in addition were mulcted in a drastic manner. The reply is cogent. But to the working classes this interpretation of equality of sacrifice seemed altogether irrelevant. They looked not to the amounts that were taken by the State, but to the amounts that were left. Suppose a man with a hundred thousand a year were to be left with only thirty thousand—*only* (they say), some six hundred pounds a week—where is the sacrifice?

The truth is that equality of sacrifice is unattainable in peace and is unworkable in war. After the acceptance of compulsory military service it is idle to speak of equality of sacrifice. It is, however, quite a different thing to argue that if it is good for the working classes to accept part of their wages in War Loan, it is also good for a proportionate part of other incomes to be advanced to the State in a similar way. A forced loan of this kind, after all, would be only the natural development of the income tax. In the case of incomes that have not risen in proportion to the rise in the cost of living (including the rise in taxes), the tax-payers, in order to pay their increased income tax are obliged to make extra savings. The State takes these forced savings, and in effect makes a forced loan—but with no interest and no return of the principal.

The income tax-payer has been warned that he may expect another increase. If, however, he were to get instead of a receipt for his extra tax a promise of partial repayment at the end of the war, even with no interest, he would be

comparatively happy, and with 5 per cent. he would leap with joy. This extension of the method of war bonuses to the income tax-payers might be begun in the most tentative way and the screw could be turned according to the capacity of the lender. A spectacular beginning might be made with the salaries of M.P.'s. What voter could refuse a forced loan if his own M.P. set the example?

It may, of course, be objected that without any compulsion the Government can borrow as much as it requires for the conduct of the war. But consider the price that has to be paid. If the present methods are continued, we may expect that the progressive rise in the rate of interest will also be continued. The more we borrow the less easy will it be to go on borrowing. With the continuance of the war the demand for new money will not be less, and the supply will certainly not be more. Where is the cause to be found that will counteract the rise in the rate of interest? Not one cause is imaginable until the return of peace.

We are told, no doubt, that during the war the deposits of the joint-stock banks have increased by some two hundred millions, but everyone knows that these deposits are not the savings of the people, but the extension of bankers' credit. There are real limits even in war-time to the sound extension of the banking credit of the most wealthy nation. Real savings from income—even if the savings are forced—serve to contract the wasteful consumption of non-combatants. The inflation of bankers' credit only tends to raise industrial wages and incomes, and by a fictitious prosperity to encourage consumption. A period of inflation is always a period of wasteful extravagance.

Once the principle of compulsion as regards public loans and interest is accepted there is no reason to fear that it will be carried into practice with dangerous haste. It is an old saying that Nature does nothing by leaps, and in this sense the British Government is the most natural in the world. We never rush the application of any new idea. We pass by tentative steps from one extreme to another.

We have seen the process in the provision of the human capital for the war. We began with voluntary enlistment in the fullest sense of the term "voluntary." We advanced step by step with painful slowness to the extreme limits of peaceful persuasion. The last steps of persuasion were a good deal more disagreeable to the people concerned than the first steps of compulsion. It is quite possible that if the "boom" in war savings continues and is extended, that here also the persuasion may prepare the way for the simpler plan. The question will come to be asked, Why should the bad men (or women) not be compelled to do what the good are doing of their own free will—with suggestions and encouragements from their ministers and their neighbours?

Compulsory borrowing and limitation of interest are not likely to be rushed. In the meantime the difficulty rather is to make a beginning. Apparently everybody is willing to begin with his neighbour. The bankers would begin with the war bonuses on wages, and the working classes cry aloud for the conscription of wealth. When everybody is willing that everybody else should begin, the principle cannot be far off general acceptance. In time the most blind will begin to see that what is good for their neighbours may be good for themselves.

A beginning of the forced loan method was very nearly made by the Government when it commandeered American securities. The first proposal was to pay for them in War Loan. Apparently this excellent plan was not in accord with the principles of private property and of equality of sacrifice as then interpreted in the City of London. The securities were paid for in cash, and it was left to the discretion or the benevolence of the seller to invest the proceeds in War Loan. As soon, however, as the sales began to fall off, a method was adopted which showed that the rigid interpretation by the City of London of the two great principles cited had been relaxed. A new kind of compulsion was accepted in spite of private property and equality. The owners of American securities who were holding back

were encouraged to come forward by a penal income tax. They came forward with a rush. The manner and the speed of their coming was approved of by the City of London.

Perhaps now another step might be taken, suggested by the American experience. Suppose that, encouraged by the success of this last device, the Government go back to their first idea, and pay for any securities they want with War Loan. To single out the forced sellers of American securities and make them accept payment in War Loan may seem inequitable. The inequity or inequality of sacrifice will disappear if the plan is applied all round. If one class of investors is to be made to invest in War Loan, why should not other classes be so compelled to a proportionate extent? Why should anyone who has new money to invest not be made to use some of it for the defence of his country? The recent activity of the Stock Exchange shows that there is new money seeking investment.

In the foregoing argument no stress is laid on any particular method, though the methods suggested are directly practicable and indirectly advantageous. The great thing to recognise at the present juncture is that continuous borrowing at continually rising rates is not sound finance in the greatest war on record. Other prices have been controlled, and in other cases the right of pre-emption on the part of the State has been recognised and put into practice, witness the regulation of tonnage and freights for wheat. Where is the difference in principle if the Government takes the money it needs at reasonable rates?—that is, of course, so far as its internal loans are concerned.

It may be said that the supply of loanable money depends on the stability of the system of credit. But an extravagant rate of interest on public war loans is neither a cause nor a sign of good national credit.

At the beginning of the war no praise was too great for the Government, which had enabled the great financial houses to tide over the expected monetary crisis. The situation was saved by the issue by the State of a mass of paper money and by other uses of public credit. These emergency

measures were continued long after the crisis, and are still continued. Why should the State, which itself provides the principal foundation of the credit system, be asked to pay so high a price for the use of it ?

The central fact is that the war must be carried on, and five millions a day must be provided—that is to say, for the most part borrowed. When we take account of the terrible sacrifices of life, where is the injustice in limiting the rate of interest on the money borrowed to 5 per cent. ? Considering the danger of an enormous dead-weight debt with a high rate of interest at the end of the war, the proposal for the present limitation of interest is one of the mildest counsels of prudence.*

* In a letter to the writer regarding this paper the late Lord Cromer stated that he had no objection in principle to a forced loan.

CHAPTER XXXIII

THE RISE IN WAR BONUSES

(*September* 30, 1916)

UNDER the threat of a strike the railway employees have received a war bonus of five shillings a week. Some of the younger workers get half this amount, and the women and some of the workers in the shops get nothing. No doubt their turn will come. The bonus actually granted to 350,000 men works out at about seven and a-half millions a year. When all the consequential arrangements have been made the bill will be larger. As the railways have for the war been taken over by the State the loss falls on the nation at large. And as we have been told many times in the course of this war, we are a wealthy nation.

It must not be supposed that the railway men are desperately wicked, and through having the control of a national necessity are able to extract a big ransom. This latest war bonus is only part of the general movement which has been going on from the beginning of the war, after a short period of readjustment. The last issue of the *Labour Gazette* shows that for the eight months ending August 31, 1916, 2,600,000 workpeople received a net increase of £360,000 per week.

These returns do not take account of large numbers of the population who have also received war bonuses, especially if we take the family as the wage-earning unit. Agriculture, for example, is not represented, and in agriculture not only have the rates of wages risen greatly, but there has been a great increase in the employment of women and children. In the towns and cities also the increase in the employment of children and old people is plain to the most casual observer. Unfortunately, the *Labour Gazette* is unable to record the family earnings of these workers, but from the samples quoted from time to time in the papers there is no

doubt that the war bonus has visited the greater part of them. The statistics of consumption and of amusements point to a general increase of spending power as regards large masses of the people. Speaking broadly, this increase is to be ascribed to war bonuses or war wages.

There are no doubt exceptions. The salaried classes in many cases have received no bonus and have had their salaries mulcted by direct taxation. People living on annuities or interest on capital are most severely hit. The capital value of the source is diminished by the rise in the rate of interest, and the interest actually received is heavily taxed.

These taxes on the fixed (or lessened) income receivers help to pay the war bonuses of the wage-earners and their families. In the last resort the greater part of the war bonuses are paid out of public expenditure. Part of the money is derived from present taxation, and the rest from anticipated taxation in the shape of public debt.

One of the amazing things in this war is the resurrection of old economic fallacies in the naked simplicity of new-born truths. There is a whole family of these fallacies, of which the central idea is that Governmental expenditure can be increased indefinitely, with an indefinite increase of the public good. This can only mean, when translated into practice, that the greater the public debt and the greater the taxation, so much the better for the national welfare. A consideration of the real burden of debt and taxes may be left for future comment. At present another of these old fallacies is of more particular interest. The idea is being revived, and put into practice on a great scale, that wages ought to rise with every rise in the cost of living. This is the root idea of the war bonus. This is the great truth which must prevail, whatever happens to the minor creeds. The minor creeds taught the people that in industries with saleable products the efficient causes of a rise in wages were an increase in the output, or an increase in the prices of the particular products, or increased efficiency or economy. Any saving of cost, *e.g.*, by improved processes

or machinery, or by lessened price of raw material not immediately followed by a fall in the price of the product, might be made the occasion of a rise in wages. During the last century industrial money wages benefited greatly in this way. Real wages benefited also by the fall in the cost of living. In the second half of the nineteenth century money wages moved up and the necessaries moved down. In those days we heard nothing of the converse doctrine that the money wages ought to fall with every fall in the cost of living. We are told, however, that at the end of the war this practical application is to be made good. That is said to be the meaning of a war bonus. It is for the period of the war. The war raises the cost of living, hence the bonus. The peace will bring down the cost of living, and the bonus will disappear automatically. Will it?

In the meantime, we have enough to do with the rise in bonuses and the immediate consequences. The rise is very unequal. A strong union in a vital national industry heads the procession. The organised trades follow in order of their striking power. The old age pensioners and others with no striking power at all bring up the rear of the procession about two years after the start.

The inequality in time is only part of the inequality of this mode of adjustment. Let us suppose that the bonus is justified in the sense that without it the wage-earner will really have to decrease his consumption of necessaries. Let us take account also of the well-established economic truth that in any enforced contraction of expenditure real necessaries are often decreased first of all. The force of habit is stronger than the force of health. Even to the best paid labour a rise in the cost of food means a contraction either of food or of some pleasing habit. Lower down in the scale there may be an enforced lowering of the standard of life by the rise in its cost.

In practice, the bonus is given first to the higher-paid kinds of labour. They at once increase their demand to its former habitual level. This increase in demand again raises prices. By the time the bonus has spread to the lowest

ranks of labour a new bonus will be demanded at the top of the scale, and so in the old phrase the mischief circulates.

These evils are recognised by the thinking part of the labour leaders. They know very well that of itself a rise in the cost of living does not justify a rise in wages. The fundamental question always is what the industry will bear. But then they say that the rise in profits shows that, as a rule, the industries can pay the bonus. It is the old conflict between labour and capital for the debatable surplus arising out of higher prices. Labour (they say) will forego the bonus if the State takes for the war all the excess profit. But labour will not forego its bonus and reduce its standard of living if profits are to rise in consequence. This argument in some cases is quite valid. Its validity has been recognised in the excess profits tax.

The argument has also a foundation of reason in a wider sense as applied to industries in general. Experience shows that in any general upward movement of prices the rise in money wages usually lags behind the rise in prices. This means that capital benefits before labour. The reason is plain. Labour contracts are not so easily adjusted as commercial contracts.

Failing the seizure by the State for the period, and for the purposes of the war, of all war profits of every kind and degree, labour, it is said, will be content to forego its bonuses, and to keep its promises not to ask for more, on condition that the rise in the cost of living is stopped. Take away the cause (says labour) and the effect will also cease. Let the Government stop the rise in prices, and labour will stop the rise in bonuses.

Hitherto the Government has put aside this request as practically impossible. It remains to be seen if the Committee appointed to investigate the rise in the cost of living will suggest any measures for practicable Governmental control. The letter of the President of the Board of Trade expounding the difficulties is not very hopeful, but the arguments advanced are not very convincing. Specially unconvincing is the appeal to the experience of other nations.

In this case the proverbial ounce of fact does not seem to outweigh the ton of theory. Look at Germany, says the President. Look at the nation which has carried to an extreme the organisation above and the docility below. Was there ever any people so obedient to so much government? And yet the cost of living in Berlin has risen 117·6 per cent. since the beginning of the war, whilst our cost has only risen 65 per cent. If German autocracy could not stop the rise in prices, how could a Coalition Government of the liberty-loving British people hope to succeed? If Germany was powerless, where should we be? There is the ounce of fact—only 65 per cent. for us, against 117·6 for Berlin. Here is the ton of theory, and in this case the ton outweighs the ounce.

A deficiency in the supply of necessaries, unless controlled by the State, raises prices out of all proportion to the deficiency. If, with the actual shortage in Germany, prices had been left to the free play of competition, they would have risen not twofold, but many-fold. Before the repeal of the British Corn Laws, when for the most part this country relied on its own harvests, the price of wheat varied according to the deficiency, the extreme being 126*s.* 6*d.* per quarter in 1812 and 39*s.* 4*d.* in 1835. Tooke, the great historian of prices, and by the way a great merchant, said that a deficiency of one-third in the wheat harvest might raise prices five, six, or even ten fold. How many fold prices might have risen in Germany but for Government action we cannot say, but, giving the devil his due, the German Government did pretty well by keeping down prices as it did, and if the necessity of control had been recognised earlier, possibly the rise would have been still less. It would certainly have been less but for the inflation of the currency, which has raised prices in general. Our financial authorities recognised the inflation of German currency at a very early stage.

Another official argument against official control is the argument from the world's price. The world's price is supposed to be determined by causes beyond the influence

of the British Government. If in this country we fix a lower range of legal prices all the stuff will be sent to the other countries which will give the world's price. On this view the world's price is wafted from overseas like the weather, and as such is beyond Governmental control.

If this argument is tested in the manner of the first argument, by reference to the experience of particular nations, even the ounce of fact is against it. Since the beginning of the war the cost of living in the United States has risen only 11 per cent., and the greater part of this rise has taken place in the last year. It is true, of course, that in order to get the national price we must always add to the world-price the cost of getting the commodity to the national market. This again leads to the contention that there is also a world's rate for freights, and if we do not pay these rates all the stuff will go to other nations. It will be interesting to see in the forthcoming report of the Food Committee, first, how much of the British rise in prices is paid away in freights; and, secondly, whether the rise in freights has preceded or followed the rise in prices. In any case, when we have the command of the sea and the control of the greater part of the mercantile shipping of the world, the fixation of an outside world's price for freights, which must be accepted like the weather, seems carrying to an extreme the old economic ideas of *laisser faire*. What is the good of the command of the seas except to secure our over-seas supplies? But if ransom prices have to be paid, where is the control of supply?

World prices, *e.g.*, of wheat, meat, etc., depend on supply and demand. The sources of supply are many, so are the sources of demand. Both supply and demand are affected in varying degrees by competition and by monopoly. Both competition and monopoly are influenced more or less by the Governmental action of various nations.

One of the most important elements affecting the demand for most of the necessaries of life is the British demand. If the British demand for foreign supplies were suddenly stopped altogether, as, for example, by some miracle of

German submarines, how great would be the fall in the world prices of wheat and other things. Instead of this country being compelled to accept world prices made outside, it is nearer the truth to say that our extravagant and unregulated demand was one of the chief factors in raising world prices.

It has been contended in this series of papers that this extravagant demand was not due simply to the necessities of the war. There was from the beginning a general laxity in public expenditure, and the root cause of this laxity was the easy inflation of currency and the credit based on it. The inflation raised general prices, and food shared in this general rise. The recognition of the inflation has passed through the two stages characteristic of popular beliefs. In the first period, when the inflation might have been checked, it was not only denied, but said to be impossible, under our excellent system of management. In the second stage, when the general rise in prices was unquestionable, a certain degree of inflation was not only admitted, but was said to be one of the unavoidable necessities of war.

In the meantime, the general rise in prices continues, and the remedy proposed is a continuous rise in the war bonuses. We are actually told that a sliding scale ought to be adopted, so that money wages should rise automatically with every rise in the cost of living. Such a scale, if applied at all, ought to be applied all round. But the wider the range, so much the greater and the more speedy must be the rise in prices. There is no escape from the vicious circle. Prices rise, therefore wages are raised. The wages are spent, therefore the prices again rise. More currency is required with the higher prices, and more currency is issued. The circular movement may continue until the foundations of credit will no longer bear the superstructure. Fortunately in this country we are in the habit of stopping short in the logical application of our popular remedies for low wages. The proposal for a universal automatic war bonus will perhaps be found impracticable at an early stage. Unfortunately its practical adoption for the strongest industries has already made the position of the less favoured worse than before.

CHAPTER XXXIV

THE REAL BURDEN OF A NATIONAL DEBT

(*October* 14, 1916)

THE expenses of the war are being met in proportion of about one-fifth by war taxation and four-fifths by debt. As between the present and future generations the proportion does not seem unduly favourable to the present on broad considerations of equity. Apart from the real burden of extra war taxes, the present race has to make large sacrifices of life and of personal liberty. Of these sacrifices the coming race will reap the chief reward, and will make no corresponding sacrifices in kind. The coming race will only have to pay interest and sinking fund on a money debt—a small price to pay for freedom from German domination and desolation. To escape so great a peril it may truly be said that no price would be too high.

When estimates are made of the probable national income of the coming race, and the proportion to be paid by way of war debt charges, the burden on the future seems still more light. In his review of the financial situation the Chancellor of the Exchequer compared the British people to the owner of an estate incurring for a necessary outlay a debt of (say) one year's income. The national income of the United Kingdom is put down at some three thousand millions, and the debt at the end of the financial year is estimated at about the same sum. Where is the danger? Where is the difficulty?

This comfortable assurance is strengthened by another assurance still more comfortable. It is said that so long as the debt is an internal debt, the payment of interest and sinking fund is only a matter of accounting from the national

point of view. By such payments, it is argued, there is no real national loss, but only a redistribution of income. Taxes are taken from certain people, and the proceeds are diverted to other people. What is lost by Peter is gained by Paul. The sum total of the national income remains the same.

Some of our optimists go even further, and try to show that the creation of a great mass of public securities in the shape of national debt adds so much to the aggregate national wealth. On this view, the greater the debt the greater the happiness, and the greater the war boom, so much greater will be the peace boom. The plain man has an uneasy feeling that there is something wrong with this political arithmetic. If nothing is to be made out of nothing, how can something be made out of less than nothing? Perhaps the best way to expose the fallacy that in public debt it is only the right hand which pays the left, and that there is no real national burden, is to express the burden in terms of taxation. It is only out of taxation that the interest can be paid, and the sinking fund (if any) put aside.

In the year before the war, 1913–14, the Budget estimate for revenue by taxation for the United Kingdom was £160,000,000. [In addition there was a non-tax revenue (*e.g.*, postal services, etc.) of about £35,000,000.]

It is true that for part of our war debt our Allies and Dominions are responsible, and so far our taxation for interest will be less. On the other hand, the expenses of the war will not end with the war. In the year before the war the total Army Estimates, including effective and non-effective services (pensions, etc.), were only £28,000,000, and the corresponding Estimates for the Navy were £48,000,000. It will be many a year after the return to peace before there will be a return to anything approaching these modest estimates for military and naval services. On balance there can be little doubt that if our war borrowing is to cease with the war, for some years we shall have to raise by extra taxation for the interest on war debt, and for increased military and naval and air charges a good deal

more than the total amount raised by taxation before the war. Already also large claims are being put forward for Governmental assistance in the reconstruction of trade and industry after the war, in the promotion of education and research and other aids to national development, and until these various betterments begin to yield their fruit they will involve more new taxation.

Let those who talk lightly of the right hand paying the left describe more in detail by what particular methods they propose to double taxation without imposing any real burden on the nation. What, for example, becomes of the right hand paying the left if the working classes are to be asked to pay double taxes?

We are told that the war expenditure has caused a great improvement in the condition of the masses of the people, and that there has been a rise in the standard of living. In the coming peace it is maintained that the first duty of the nation is to see that this higher standard is not impaired. The only difficulty is to discover the practical methods by which this first duty is to be achieved. Several have been propounded by scientific and other philanthropists. The workers are to work more and to produce more. The trade union restrictions on the efficiency of labour are to be annulled. Devices for "making work" are to be displaced by preventives of waste of labour. These and similar commonplaces of old-fashioned prudence, when stated in the abstract, are no doubt as admirable as the greatest happiness of the greatest number.

But if the working classes are told that the real reason why the labour machine must be speeded up is that labour may be able to bear more than the pre-war taxes, their zeal for high-pressure work will cool down. And the cooling process will not be lessened by the assurance that the proceeds of their taxes—the payments by their right hands—will go into the left hands of the fund-holders, or through various beneficent Governmental officials and sub-officials be devoted directly or indirectly—especially indirectly—to the improvement of the condition of labour. When it

comes to the payment of taxes out of wages, how many of the working classes would approve of an indefinite extension of the method of compulsory insurance, even for their own benefit? If, however, the taxation of wages is to be increased beyond the pre-war level, not to provide more insurances for labour or more improvements in the conditions of labour, but simply to enable labour to pay its share in the interest on the war debt and in the increased charges for the new peace footing of the Army and the Navy, who will be bold enough or foolish enough to tell them that the taxes are no real burden because the proceeds will be spent within the country? Taxes that have to be paid to meet the expenses of a dead war and its consequences will be about as popular with labour as making up long arrears of unpaid insurances. Already some of the representatives of labour are saying that they have given their blood, and other people must give their money—that the conscription of life can only be balanced by the conscription of wealth. It is useless to reply that the professional and others of the non-working classes have given in proportion probably more life. No consideration of this sort will make war taxation that falls on labour seem other than a real burden to labour. The right-to-the-left-hand theory breaks down altogether when it is applied in the concrete to actual taxes on consumable things. How are we to show that the particular part of the interest on our war debt that is to be paid out of the extra tax on tea is only a right-to-left payment that involves no real burden on the masses of the people? And where is the essential difference between a tax on tea and any of the other taxes that may be imposed on the consuming power of labour?

Any adequate estimate of the real burden of taxation that affects the consuming power of the working classes ought to take account not only of the discomfort involved, but of the indirect effects on national productive power. The flow of emigration that is expected to set in after the war will be increased by every rise in the taxes that affect labour. The continuous struggle on the part of labour to find com-

pensation for higher prices in higher wages will tend to raise the cost of labour, and there will be a reaction on foreign trade. It is, however, useless to recall the lessons of history on the crippling effects of heavy taxation on national productive power. It is quite sufficient for the present purpose to consider the direct burden of war taxes intended to fall on labour. And when peace comes and the war bonuses cease—when, instead of spending the proceeds of loans, we begin to pay interest on the loans by the proceeds of taxes, there will be no need to show to the labour concerned that taxes on labour are burdensome—in other words, that the part of the interest on the dead war debt that is paid by labour involves a very real burden.

The probability is that the burden of any taxation meant to strike labour and intended to pay for war charges and not for the direct benefit of labour will seem so great, and will be resisted by so great an outcry, that it will not even be attempted.

Precisely the same arguments may be applied to wealth as to labour. We must translate all our proposals into definite taxes. Let us begin with the income tax. Even before the recent lowering of the limit of exemption, by which over a million of the wage-earners have been included, most of the people who paid income tax earned the whole or part of their incomes by labour of some kind. As the census returns show, the unoccupied class of possible workers—the conscientious objectors to work of any kind—is really very small. It is true that the British income tax differentiates between earned and so-called unearned incomes, and higher rates are imposed on the unearned. In theory, the idea is to distinguish between the terminable earnings of the higher forms of labour and the otiose interest derived from capital that is assumed to be permanent. In practice the division between the classes is to a great extent arbitrary, and the justification from the national standpoint seems very doubtful.

It is very difficult to separate pure interest from the other elements with which in practice it is conjoined—*e.g.*, the

insurance against all kinds of depreciation of the supposed permanent source.

The more closely we look into the interest yielded by the varied investments of British capital, the less appropriate seems the term "unearned"—if by unearned we mean that the receivers of the interest have conferred no corresponding national benefit. In the time of peace the investment of British capital abroad has given us new sources for raw material and food, and in that way greatly increased the real wages of labour. And in the present war the large excess of imports of war materials for ourselves and our Allies has been paid for by means of these investments. From the beginning of the war we have been told that we could outlast the enemy on the financial side. Suppose that instead of these large investments of capital the owners had wasted their substance in riotous living, or suppose that the surplus had been devoted entirely to raising wages, and that the wages had been spent in what in the working classes is called keeping up the standard of life? Where would have been the reserves of financial strength of which we are so confident? From the national point of view, the interest on capital in normal times is a cheap price to pay for the accumulation. If taxation on capital cuts away any of the gross earnings which ought to be devoted to insurance against depreciation of all kinds, the wasting of the capital is still more rapid.

On the advent of peace we are told that there will be unheard-of openings for British capital. We shall be able to pick and choose the best parts of the field formerly occupied by the Germans. But if every extra gain from enterprise is to be snapped up as unearned increment or as excess profit, the enterprise will not be forthcoming, or the corresponding capital will find a home in foreign lands. Capital is still more ready than labour to leave the land of heavy taxation.

The capture during the war of excess war profits is on quite a different footing. Such profits arise because Government made bad bargains with its contractors, or allowed

monopoly prices to be exacted, which ought to have been regulated.

After all, however, of the incomes that are subject to income tax in this country, the largest number are earned in the narrowest sense of the term. The incomes are the wages of the higher forms of labour. A large mass of the salaried classes receive lower pay than the better-paid artisans. Are we not told that one condition of improving the educational system of the country is to give higher pay to the teachers? In their case also we are asked to apply the principle of the economy of high wages. To reduce their earnings by taxation is surely a queer beginning. Many classes of income tax-payers—the professional classes and most of the middle classes—will certainly find the continuance of war taxation after the peace a heavy burden. If the income tax is not a burden, why should so much stress be laid on the exemption from income tax of the War Savings Certificates?

Similar arguments may be applied to every part of our tax system. It is only other people's taxes that seem to us too light—only the excess of incomes above our own that seem unearned. The really unearned incomes, after all allowances are made and all precautions are taken against injuring the source, are not nearly sufficient to meet the dead-weight charges of the war debt.

So long as the public loans are being spent as they have been spent in this country during the war, the receivers of the money do not feel the burden—their war bonuses exceed their war taxes. There is a general feeling of prosperity amongst large classes. In the careless expenditure of the loans the old peace standards are lost sight of. A million a year is a mere trifle. What is one amongst so many? If we borrow a thousand millions at 6 per cent. instead of 5 per cent., what is ten millions a year to a great country like this? The true answer is ten millions more in taxes.

Early in the war we used to assume that with the return of peace borrowing would come to an end and the war taxes would be reduced. If borrowing does cease there must be

a great hardening of heart of our financial advisers. Loans for reconstruction will be called productive. Government will be invited to make vast speculations in unearned increments. All the old arguments on the socialisation of national welfare will be worked into excuses for more debt.

In such an atmosphere, to stop borrowing and to continue war taxation will be hard indeed. But some time or other the borrowing must stop, and the longer it lasts the heavier the taxation to pay for it—unless the speculations for unearned increments under State management have a miraculous success.

The foregoing argument is not meant to imply that on the financial side we have reached the limit of our war strength. Not so. We can borrow more, and we can pay more taxes. We have a long way to go before we reach the strain already imposed on the other belligerents. But, morally as well as economically, it is time for us to think of debt in terms of deferred taxation, and to think of taxation not as a national benefit but as a national burden.

CHAPTER XXXV

FREE TRADE AND PROTECTION

A Reconciliation

(*November* 25, 1916)

It is quite easy to state the case for Free Trade on the one side and for Protection on the other in such a way that reconciliation is impossible. This way is, indeed, not only easy, but popular. Each side lays down a set of short and simple dogmas, and if they are not at once accepted and put into practice, accuses the other side of a shortage of intellect or morality. Says the Free Trader—"Every import means an export. Open wide all the doors. Make no charge for admission. All will be well if you only stick to free imports." Says the Protectionist—"Markets are limited. The home producer has the first claim to home markets. Impose on all foreign goods an all-round entrance fee, with extra charges for the better places, and no admittance to the very best." Between absolute freedom of entry and a minimum tariff graduated up to total prohibition no reconciliation is possible.

This is only one example of the opposition of popular dogmas on Free Trade and Protection. There are many more of these opposites—each to each, as we used to be taught in our Euclid. Look to the consumer, says one. Consumers must first be producers, says the other. In time the dogmas take on the fervency of religious creeds. The controversy is waged with more than the proverbial theological hatred and narrowness. I once asked the late Professor Flint—the last survivor of men of universal knowledge—if there was any more narrow-minded man than the materialistic man of science. None, he said, except the

theologian. The dogmatic Free Trader, and equally the dogmatic Tariff Reformer, each in his own way combines the narrowness of the two kinds.

Fortunately, although there is no way of reconciliation of these extreme popular dogmas, there are two well-tried paths of peace still open. The first is shown to us by the experience of great nations, and the second by the wisdom of great writers.

Take first the appeal to the history of great nations. The appeal reveals an extraordinary combination of the two opposing methods—namely, the methods of Free Trade and Protection. In all the great progressive nations internal Free Trade has displaced internal Protection. There was a time in England when every town protected itself against every other town. Every town had its own market or markets, and the foreigner was only admitted under the most suspicious surveillance. For this purpose the native of any other town was a foreigner. The market regulations of the towns of mediæval England are as curious as the armour and the dresses. And yet every one of these fantastical regulations had its origins (like the superstitions of the Golden Bough) in reason according to the outlook of the times. But with the growth of a national economy all these curious devices were whittled away into nothingness.

When England was united to Scotland the opposing Protections were welded into one internal Free Trade. One of the most enduring of Irish complaints was that the union with England involved Free Trade—but the rule was followed. In the mighty colonial expansion of Britain one of the causes of the American disruption was that this policy of Free Trade within the Empire was not sufficiently developed. Britain, indeed, gave much greater freedom in the way of trade to its colonies than did any other great nation, but the restraints that were imposed in favour of the Mother Country—the Protectionist policy of England against its own colonies—was a source of sentimental friction.

Other examples on a large scale of the development of

the rule of internal Free Trade need only the barest mention. The United States of America within its own borders has Free Trade. The German Empire only began to be an Empire when it abolished the multitudes of the Customs duties imposed in truly mediæval fashion by each of the German States against the rest. The British Dominions have followed on the same lines of internal freedom. Inter-State Protectionism has been broken down on the accomplishment of a wider and closer political union.

It is not unreasonable to argue that this displacement of internal variegated Protectionism by uniform Free Trade in national development must have as its basis some great national advantages. In the history of nations the advancement towards internal Free Trade stands out almost as a natural law of progress.

It is, however, equally remarkable that if internal Free Trade has been one of the goals of national progress, so also has external Protection. The United States and the German Empire, for example, have combined external Protection with internal Free Trade. So has Italy, so has France, and, indeed, there is only one notable exception. Who can say off-hand that, in the light of experience, external Protection has retarded the industrial progress of these great nations?

The one notable exception is furnished by the British Empire, and there the exception is only partial and may be said to prove the rule. The British Empire, as a whole, has not adopted internal Free Trade. The overseas Dominions are Protectionist against the Mother Country. It is, however, noteworthy that with the growth of ideas of closer political union advances have been made in the direction of internal Free Trade by the development of preferential duties. Probably this movement would have been accentuated but for the fact that the United Kingdom was itself the only notable exception to the general rule of external Protection. Owing to this policy, we had nothing to offer in return in the way of preferences. But in the light of the present war the most confirmed Free Trader would hardly deny that within the United Kingdom there has grown up a strong

feeling that as regards enemy countries the United Kingdom, for a more or less considerable period at any rate, must break with the simple rule of freedom and follow the example of the other great nations.

Surely in the light of this broad survey, it is reasonable to suppose that in each of these great policies there are elements of strength and advantage. The old argument that Germany would have been even more prosperous under Free Trade may be balanced against the other old argument that the United Kingdom would have made even greater progress under external Protection. Probably Germany would have done better with less cunning and Britain with less simplicity.

The conclusion suggested by the appeal to experience that in both systems there are elements of advantage is confirmed by the wisdom of great writers. This is the second path of reconciliation, and may be specially recommended to the practical man. The practical man dearly loves to quote a recognised authority in support of his argument. The worst of it is that in economic ideas a writer only becomes an authority after he is dead. And then the practical man on the other side is apt to retort: "What can a dead man know of the problems of to-day?" Adam Smith, we are told by the practical Protectionist, published his great book just one hundred and forty years ago. The odd thing is that the same practical man will give as his authority List, oblivious of the fact that List published his great book just seventy years ago. Are we to suppose that the authority of List is just twice as good or twice as fresh? Of course, when we look carefully into the meaning of this time test, we find that the really great writers are always in advance of their time, and that time never overtakes and passes the greatest of them all. The practical Free Trader and the practical Protectionist may be well assured that Adam Smith and Friedrich List are both still in advance of the dominant living thought of their respective countries. Their books will not give cut-and-dried answers to our practical problems, but they will give some of the ideas by which they may be solved. And, as it happens at the present crisis, what is

most needed is to emphasise the points of agreement rather than those of difference in these two great writers.

The Germans have begun to discover the greatness of their prophet a little too late. In the matter of creative ideas List was the architect of the German Empire. So long as the builders followed his plan that Empire grew and prospered. It is now threatened with ruin because they have brought in a new set of ideas, or rather they have revived old ideas which to List were repugnant.

The dominant influence over List was the expansion of England into the British Empire. List thought in history, and most of all in British history. On occasion List made most bitter attacks on English policy, but his eulogy of the British Empire as compared with other great Empires is enthusiastic. At a time when Germany was split up into a number of principalities with its own protective policy, List drew up his scheme for a great Customs Union, with internal Free Trade amongst all the German States. Internal consolidation on a Free Trade basis was to be followed by external expansion with protection against outsiders, especially against England. On the view of List, England had gained her commercial supremacy by the methods of Protection. She only threw away the ladder when she had reached the summit.

Germany was to follow the example of England not only in commercial but in political expansion. The Government of the new Germany was to be constitutional, and based on liberty. Greater Germany was to expand through South-Eastern Europe into Asia. Turkey was to be the German India.

Greatly influenced by England, List was a firm believer in the power of the sea. Germany must also have overseas possessions protected by her own navy. This great German Empire was to be created not on the ruins of the British Empire, but side by side. The world was big enough to admit of both expansions. List hoped for a real, genuine alliance or understanding with England. The last efforts of his life were directed to the furtherance of such an agree-

ment. His latest biographer says that he died of disappointment on the failure of his proposals for such a closer union.

It is easy to see now where the latest German builders went astray. They stifled constitutional liberty and set up militarism. In place of friendly rivalry with the British Empire, they planned its destruction. No wonder that in Germany the cry is now being raised of "Back to List."

List was no narrow Protectionist. He was the very reverse. He was the greatest of the Protectionist writers, but the greatest because he was the broadest. If our own narrow Protectionists would only read List instead of misquoting him they would shiver. Did their own particular prophet really say that England ought to have adopted Free Trade immediately after Waterloo instead of waiting for the potato famine? He really did. Did the same prophet really say that protective duties were properly only educative taxes? Did he also think that agriculture needed no protection? That all duties should be moderate, and none prohibitive? Yes, these and many other queer ideas were held by the greatest prophet of Protection. It might, perhaps, be thought that List was a careless writer, and his little exceptions must not be taken without the context. He was certainly a very careless writer. Most of his life he was a journalist. A journalist has not time for research. His consistency is of the short-period variety; how else can he be up-to-date or interesting? List, however, was not merely a journalist, but a great thinker and an enthusiast for certain great ideas. Amongst these great ideas were his ideas on commercial policy.

One of the most careless things that List did was to affix the name of Adam Smith to opinions which were in many cases the very reverse of his fundamental positions. It is true that very often List attacks, not Adam Smith by name, but what he calls "the School." "The School" is the short name for the narrow dogmas on commercial policy associated with the name of Adam Smith. Sometimes, however, List misuses the name of Adam Smith and fastens it

on to dogmas utterly opposed to the real ideas of the old Adam.

If the narrow Free Trader will only read Adam Smith instead of misquoting him, it will be his turn to shiver. And he will probably shiver even more than the follower of List, because Adam Smith was the very reverse of a careless writer. He spent the greater part of his life in getting the material for the "Wealth of Nations," and he took about ten years to write it. He was not a journalist in a hurry—quite the contrary. He is, however, one of the clearest of writers. He uses no technical words. He is popular in the best sense of the term. He is not a mathematical economist. Anybody who can read a leader in a newspaper can read Adam Smith. But whilst the reader of a leader generally finds in it more or less what he buys his paper for, the present-day Free Trader will find in his Adam Smith a series of shocks and surprises. Instead of being cosmopolitan, Adam Smith was intensely nationalist, or rather Imperialist. This part of his work, after being entirely neglected, is now bearing fruit. Adam Smith wrote on the eve of the disruption of the British Empire by the severance of the North American colonies. He propounded as an alternative a great federation with a truly Imperial Parliament.

Free Trade was only one part of his subject, and in his statement of it he also stated the fundamental ideas of what is supposed to be the alternative policy of Protection with greater force than they have been stated by any professedly Protectionist writer. In no writer, for example, is so much importance attached to home trade and the employment of labour and capital in the home country, and especially in agriculture. It is against the methods of Protection that his attack is directed. The restraints, he argued, must in nearly all cases be either hurtful or useless. That is the great negative argument for Free Trade that has always been its strongest support.

The popular idea that Free Trade is always theoretically the best policy for every nation, but that for practical or political reasons some occasional exceptions may be admitted

is just the reverse of the teaching of the great economists from Adam Smith downwards. It is easy to point out in theory most important exceptions—the real difficulty is to put them into practice without causing more mischief indirectly. Adam Smith's most famous exception to Free Trade—and one of most interest at the present time—was the policy embodied in the Navigation Acts. Curiously enough, this was the first part of the old system to break down, simply through the difficulty of working it in practice.

It is not, however, for their treatment of any particular problems that the modern reader is recommended to read either Adam Smith or List. To learn to quote them correctly may be an elegant accomplishment, but probably misquotation would be more popular. The real use of reading these great writers is to get some of their breadth of view and elasticity of thought. When the present war comes to an end there will be an opening for laying down a great national trade policy such as never before was offered to this country or this Empire. There is an unrivalled opportunity for breaking away from old dogmas and taking the best of both great policies.

The real strength of Free Trade lies in the stress laid on the character and initiative of the individual. Its great danger is that unlimited competition may destroy the ideas of nationality and national welfare. The strength of the opposing system is in organisation and in the stress laid on the power of good government. Its great danger is that too much government will destroy the character and force of the individual.

List brought out most clearly and emphatically the necessity of organisation—Adam Smith the necessity of giving full play to individual energy. What we need at present is the best of both systems. And what we have to avoid is the worst in both. On these general texts many practical sermons might be written.

CHAPTER XXXVI

INFLATION AND THE RISE IN PRICES

(*December* 23, 1916)

THE public expenditure, according to the statement of Mr. Bonar Law, has risen from £5,000,000 to £5,700,000 a day. The total expenditure of this country since the outbreak of the war is £3,852,000,000. "It is a colossal figure, but I do not think it is an appalling figure." If it is not an appalling figure it is only for the reason given by the Chancellor in the sentence immediately preceding: "I do not think we can in the least grasp what it means." It is surely time that the Government and the people of this country began to realise the meaning of this "stupendous" war expenditure. With national service, unless we alter our methods, another great rise in expenditure must be expected.

There are many ways of getting pretty vivid ideas of the real meaning of our expenditure. We can work it out in terms of taxes—every man for himself. The end of the war will not mean the end of war taxes; it will only mean the end or the beginning of the end of spending borrowed money. The appointed time will come at the end of the war for the stoppage of the war bonuses.

Another vivid way of realising the effect of our expenditure is to consider the terms on which the British Government can borrow the money it needs. In the home country it pays 6 per cent. for loans repayable in three years—the kind of period that gives to the lender the maximum advantage of the combination of the short and the long period loan. It is true that some of this interest is got back in income tax. But we are also borrowing from Japan at

6 per cent., free of all taxes. In the United States we have to provide collateral security. The Federal Reserve Board has warned the banks against locking up their resources in the bills of warring powers which will have to be continually renewed. The warning was specially directed against the Treasury bills of this country. To our own bankers and other providers of money in a liquid form these bills have been issued to the extent of over 1,100 millions. From the banking point of view this also ought to be a pretty vivid way of grasping the meaning of "colossal" and "stupendous" when applied to our public expenditure.

Another vivid way of realising the weight of the burden of the war is to consider the rise in prices. Once more the *Economist* idex number has passed all records. Compared with the basic number of 100 for the years 1900–05, and with 116·6 at the end of July, 1914, the last return for November is 217·2. That is to say, as measured in this way prices have more than doubled compared with the beginning of the new century.

It is to this aspect of our "colossal" expenditure that singularly little attention has been paid by our financial authorities. Yet it is roughly true that if the prices of things in general have doubled, our aggregate expenditure has so far been also doubled. If the rise in prices is to continue, then for the same quantities of munitions and other supplies we shall have to pay increasing amounts, and another 20 per cent. rise in prices will so far mean another million a day.

In the first paper of this series, published in the first week of the war, the question was discussed of the possible effects of the war on prices. Contrary to the popular opinion, it was shown that there is no necessary connection between war and high prices—that is to say, general high prices. Some things, of course, immediately rise in price owing to the special demand for war purposes, as in the old days for saltpetre and cordage. But, as was clearly shown by Tooke in his great "History of Prices," up to the end of the eighteenth century there was no observable coincidence

of a general rise in prices in war and a fall in peace. He confirmed the opinion by a table of the years of war and peace extending from 1688 to 1792. A similar survey from that period down to the outbreak of the present war gives the same result. The alternations between high and low ranges of prices do not conform to the alternations between peace and war. For two years after the conclusion of the Franco-German War prices rose very rapidly to a much greater height than during the war.

It was, however, admitted by Tooke that "if a state of war includes the supposition of an increase in the quantity of money, then indeed the case is altered." Following up this same principle, I pointed out that the course of prices in the present war would depend largely on Government policies regarding money. If a general war should lead to a general contraction of credit and a pressure on gold—as seemed very probable in the first week of August, 1914—so far general prices would tend to fall and not to rise. If, on the other hand, the currencies of the nations were inflated by large issues of paper money, and credit were inflated by exceptional Governmental guarantees, then a general rise of prices might be expected. If in any country inconvertible notes were issued without due regard to the principle of limitation, then no limit could be assigned to the rise in prices in the country concerned.

The course of events has shown that all the Governments of the great belligerent countries have inflated their currencies and expanded their credits. Instead of there being any world pressure on gold, the reverse has happened. Gold has overflowed into neutral countries, so that they have become alarmed lest the excess of gold should in their case also give rise to inflation. Sweden has placed limitations on the payment for her exports by gold and on the coinage of gold.

The United States has at present only reached the stage of lamentations on the over-abundance of gold. Mr. Wilson has not yet written a note about it. But the American Labourists have written a note to Mr. Wilson on the rise

in prices. They have invited him to say whether the rise in the cost of living—which has at last become noticeable in the United States—is to be ascribed to cornering and profiteering or to a shortage of American stuff due to exportation to Europe. The President, when he has had time for looking into all the evidence, will perhaps reply that the rise is largely due to an over-abundance of money, and that in a state of war a certain amount of inflation of prices is as unavoidable as a certain amount of sinking of American and other neutral seafarers. War prices and war risks in America, as elsewhere, may be made to answer for a multitude of financial sins.

That an undue increase in the quantity of paper money is likely to bring about an inflation of prices was perhaps that part of economic theory which before the war had been most commonly accepted as true and abundantly confirmed by history. All the great nations had been warned by their own experience of the dangers of over-issue of paper money, and had placed such issues under stringent regulations. In no country had the regulations been made so stringent as in England. The system of the Bank of England was described as a cast-iron system.

This excessively stringent regulation of the note issues was the more remarkable because as regards other forms of bankers' credit the maximum of freedom was allowed. Any bank could give a cheque-book to whom it pleased, and open an account under any conditions it liked. The kinds of investments and the proportion of reserve were not governed by bankers' law, but by bankers' sense.

The contrast between our cast-iron system in notes and our cast-loose system in all the other functions of banks was often the subject of comment, generally sarcastic. But the general opinion seemed to be that after all it did not matter much what the regulations were regarding the notes, because the notes were practically of very little importance in such a country as this.

More than forty years ago Bagehot called attention to the democratic character of our banking as one of the great

factors in our commercial supremacy. Since that date the democratic character has been intensified. In the address of the President of the Institute of Bankers, published in the current number of the Journal of the Institute, it is said that there are about five million accounts open with the joint-stock banks. Taking the deposits at one thousand millions (the pre-war figure), that gives an average of £200 per account. In the same address it is said :—" Our system has made it possible to dispense with coin and notes in the everyday transactions of life, and it has gathered into one great store the loose cash of the people."

When we know that the bankers' clearings amount in normal years to over £16,000,000,000 per annum, and know also that this amount represents only part of our credit transactions, and when we set against these fabulous sums the tiny amount of gold and notes, there is no wonder that we were accustomed to look on the notes and their functions as quite insignificant.

Accordingly, when on the outbreak of war the Government printed off one pound and ten shilling notes as fast as they could, nobody supposed that anything unusual had happened. Any banking criticism was directed only against the quality of the paper and the printing. Not only was the old principle of limitation abandoned, but the new one put in its place was the very opposite. Any bank was to be allowed to get the new notes up to 20 per cent. of its total liabilities and current accounts as shown in its monthly statement last issued before August 6, 1914. The amount of notes issued was treated as an advance by the Treasury to the bank, bearing interest from day to day at the current Bank rate. The bank was allowed to repay the whole or any part of such advance either in currency notes or otherwise.

The consequence of issuing notes in this way, with the provision afterwards made effective that they could only be converted into gold at the Bank of England, was to make the notes *de facto* inconvertible. This country gradually adopted in an indirect or disguised manner the method of

inconvertibility which had been avowedly adopted by the other belligerents at the beginning of the war. With inconvertible notes it cannot too often be repeated that the only way to limit the rise in prices is to limit the notes.

In the case of these other belligerents we have no difficulty in ascribing a good deal of the rise in prices to the inflation caused by excessive note issues. The case of Russia is perhaps most interesting. One of the reasons for our ill-fated Dardanelles expedition was to make available the over-abundant supplies of Russian wheat and other food-stuffs. Russia was the land of plenty. Yet, according to the last Russian supplement of the *Times*, prices in Russia of the principal articles of consumption have risen actually more than in Germany. Of seventeen articles quoted, only six had risen more in Berlin than in Moscow, and grain, sugar. and meat had increased in Russia from one and a-half times to twice as much as in Germany.

In the same way we are all quite prepared to admit that in Germany one of the causes of the great rise in prices of all kinds is the over-issue of paper money.

Why, then, should we suppose that we alone are to be exempt from the consequences of the inflation of our currency? Is it really the fact that "it is possible to dispense with coin and notes in the everyday transactions of life?" Is it true that we have so developed our cheque system that the amount of issues of the notes is of no practical importance? By all means let the experiment be made. Let the wages bill of the country for a single week be paid in cheques, and let these cheques be the only currency. Let the multitudes of our workers go into the shops or the railway stations or the public-houses and offer their cheques in payment. The experiment will not be made, because it is impossible.

This last week there has been a further large expansion of Treasury notes, and the total now outstanding is over 141 millions. How much longer are these increases to take place? Has our vaunted cheque system broken down? On the contrary, everybody knows that our banking business has never been more active. And part of this extra activity

is due to the simple fact that our banks as a whole, instead of having to keep up a stock of "hard" money to provide for their internal needs, have only to get a sufficiency of "soft" money in the form of the Treasury notes.

In the time of the great bimetallic controversy in the 'eighties the commercial and financial stability of this country was supposed to depend on the maintenance in its full integrity of the gold standard. In those days our bankers worshipped the gold standard. To them it was unthinkable that monetary contracts made on a gold basis could be settled in silver. Even in the United States the chief argument against making silver full standard money for all purposes was the fear of over-abundance and inflation. Silver was branded as "soft" money. The "hard" gold standard was not to be diluted with the "soft" silver.

But silver, after all, is a precious metal, and, compared with unlimited paper money, silver is adamantine in its hardness. So long as the paper money is under all circumstances immediately convertible into gold on demand the provision of the gold gives a necessary limitation. But we have increased the issues of our Treasury notes since May, 1915, by one hundred millions without providing any new gold in reserve. And still the issues continue. What is the reason for this marked neglect of the principle of limitation, which is the foundation of any sound system of paper money? The artificial stability of the exchange with the United States, which is kept up by a stream of exported securities, is no evidence that within the country there is not a general depreciation of the currency. Of course, so long as people are content to ascribe the high prices simply to "the war," they will pay no regard to the excessive issues of paper money. Even bankers as a rule pay no attention to movements in general prices. Bankers, however, ought to have observed with some concern the cases recently reported of heavy penalties imposed on persons in this country for attempting to sell sovereigns for a shilling or eighteen-pence above the normal value.

Quite recently the argument has become fashionable that

high prices are a blessing in disguise, because high prices check consumption. High prices do not check consumption if for every rise there is a demand for war bonuses to meet the rise in the prices. High prices check consumption only if the incomes of people remain the same. But by the lavish expenditure of borrowed money the incomes of large masses have been raised. So long as our credit and securities last we can pay the high prices for imports, but the method of war bonuses is fatal to any economy through high prices. In one of his latest official utterances Mr. Runciman said that too little attention had been paid to inflation. It will be extremely interesting to observe any steps taken by the new Prime Minister to check inflation and extravagance. An old proverb reminds us that he ought to make a very good hand at the business.

CHAPTER XXXVII

THE GENEROSITY OF THE WAR LOAN AND THE ALTERNATIVE

(*February* 3, 1917)

ANY criticism of the War Loan during the period of subscription may perhaps be considered out of season. Fortunately, however, the most severe criticism that can be offered ought to give the greatest encouragement to investment in the new loan. Every point of criticism is a point in favour of the investor. The chief fault of the loan is that it errs on the side of generosity. The terms offered to the investor are too favourable. There is, however, a perfectly simple explanation of the present high rate. From the beginning of the war the Government has always been paying more than it ought, not only for its goods and its labour (except the labour of actual fighting), but for its money. Not only was the rate of interest raised too rapidly to too great a height, but the Governmental loans were made more attractive by a succession of curiosities in the way of war bonuses.

Every bonus on War Loans—every extra little attraction to the investor—costs money. It costs money that must in the last resort be raised out of the forced economy of taxation. No amount of misty circumlocution can hide this simple truth. The cumulative effect of these little bonuses is to raise the rate of interest. Besides the expense, they create a mass of unnecessary complicated business and dull the sense of patriotism. The lender to the State is taught to expect more and more favourable terms.

One example strikes the eye at the present time. Just at the critical stage of the war, when most of all new money is needed, the business energies of the financial world are

distracted by the complicated conversion of former loans. These conversions not only bring in no new money—it was part of the bonus on the old loan that no new money was to be demanded on conversion—but the effect is to make a fresh demand on new money raised by taxes to pay the increased interest. The expense of this bonus was not the only evil. Ever since the promise was given the old subscribers have been looking out for the higher rate. They understood not only that they would share in a rise in the rate of interest if a rise were necessary, but they were led to believe that a rise must come as a matter of course. The delay was a grievance. Accordingly when the new loan was announced with the higher rate, and with some of the usual little bonuses, they only thought that their just expectations were at last being realised.

The present high rate offered for the new loan, and the garnishing of it with new bonuses, has nothing whatever to do with the security of the loan. For the ordinary investor as distinct from the speculator, the new loan is the best security in the market. This was made evident by the fall in the price of other securities, which simply meant that they became less attractive as compared with this new loan.

The only reason for calling attention once more to the weakness of the financial policy which has raised so unduly the rate of interest on British Governmental loans is to emphasise the investor's present opportunity. The generosity of the loan is too great because the former financial policy was too weak. The financial policy was not only weak, but wasteful. It was bad economy just when good economy was most needed. In a war of endurance everything in the last resort depends on economy. And economy covers a good deal more than a healthy reduction of meat and drink. It includes economy in borrowing money. Economy, said the old Latin tag, is the greatest source of revenue. It was long ago pointed out in these papers that the British Government by any test was paying far too high rates for its money. The only excuse offered that made

any show of reason was that it was necessary to pay high rates to attract neutral money. At last, after millions have been wasted, we are told in the sober columns of the *Economist* that it is quite easy to pay higher rates for neutral money than for home money. Such, indeed, it is now said, is the belief in the City. It is discouraging to think that it should have taken years of war to discover this plain truth. Everybody knows that there is not one rate of interest, but a multitude of different rates, varying with different conditions. Anybody who professes not to know has only to look at a Stock Exchange list. The British Government could offer on every point the best conditions favourable for a low rate. Not only is the security the finest in the world, but from the very beginning of the war a stringent check in this country had been imposed on any other kind of investment. The Government really put itself in the position of having a buyer's monopoly in the borrowing of money. But this immensely strong position was frittered away to such an extent that the British Government was actually paying last year more than 6 per cent. for short loans in its own market.

The new Chancellor of the Exchequer could not all at once break the vicious habit of the war bonus in the matter of borrowing. But he has taken the first step. Instead of saying to the doubting investor, "Please do not hesitate to lend now, for as soon as ever the rate of interest rises, and it will not be long, you shall have your share," Mr. Bonar Law told him that he would never again have so good an offer. He intimated also at the same time that if the present loan did not answer the national requirements, the next would not be so favourable and the method would not be voluntary. That was the alternative.

It would do much for the success of the loan if this part of the argument were enforced by those in authority with more vigour. The war must be carried on. The land is a land flowing with money and credit. In the face of the quantities and qualities of compulsion already swallowed any squeamishness about a forced loan would be ridiculous.

For many reasons a voluntary loan is preferable. But when the income tax on incomes from investments has reached five shillings in the pound, to say nothing of the super-tax, to the owner of capital a forced loan might well seem preferable to a still higher income tax. Perhaps the strongest objection most people feel to a forced loan is in the sentimental idea that Germany has not yet been compelled to adopt this expedient. If Germany has evaded this special form of compulsion, it is only because more and much worse forms of compulsion have been enforced. We have had far too much of comparisons with Germany. Surely by this time we ought to be rather encouraged to take any course of action not adopted by Germany.

In the meantime, further consideration of the alternative may be deferred. It is sufficient to be assured that the present terms for the free-will offering are better than any terms to be offered in the future, whether voluntary or not.

It seems pretty clear that Mr. Bonar Law himself thought that 5 per cent. was the limit for the British Government in its own markets, even though that 5 per cent., like all the other incomes from other investments, was subject to income tax varying with the needs of the country in war-time. It was a pity he was induced to spoil the sweet simplicity of the 5 per cents.—what a change in itself from the sweet simplicity of the old threes—by the addition of bonuses, which mean probably that the real cost of the loan is nearer 6 per cent. than 5 per cent.

All these bonuses, however, which add so much to the cost of the loan to the State, are so much added to the benefit to the investor. Consider, for example, the Sinking Fund. From the investor's point of view the effect will be that the price of his security will be more steady. The very object of the Sinking Fund is to steady the price of the loan. So far as it operates it will have this effect. It will be an additional element in value of the new loan compared with other investments not so provided. But from the point of view of the State, a sinking fund that is not

raised by taxation is usually worse than useless. If there is no surplus of revenue, it must be itself raised by borrowing. And generally this means borrowing at a higher rate. If, however, by the aid of a little compulsion the Government in the future borrows at more reasonable rates, the Sinking Fund used to extinguish some of the old debt may pay its own expense. In any case, the investor in the new loan has another little bonus in the Sinking Fund.

In the same way the price of issue at 95 is not good finance from the public point of view. It means that for every £95 pounds which the Government receives it pays £5 interest, whilst the debt to be repaid is £100. If with its conversions the new loan reaches only 2,000 millions, the Government will have to pay back a hundred millions more than it has received in capital. But once more we have an excellent little bonus for the investor. With the close of the war his stock is likely to rise to a premium on the price of issue.*

The concession by which the income tax is not levied at the source, having regard to the frailty of human nature and other hazards, is likely to reduce the revenue and to save the pockets of the tax-payer who owns War Loan. Similarly the provision for the payment of death duties in War Loan Stock gives the Government its own paper instead of new money—again a benefit to the private lender at the expense of the public borrower.

It is not necessary to dilate further on the generosity of the loan, and the time for the alternative is not yet. There are, however, two points on the generosity side of the argument which may still be pressed on those in authority. There is the appeal to the small investor, and there is the appeal to the investor who has to borrow the money. It is doubtful if within the limits of time assigned for subscription these

* In Part II., Chap. IX., p. 222 *sq.*, on the probable effects of war on the rate of interest, a considerable rise after the war was anticipated. The possibility of the Five per cent. War Loan rising above 95 after the war depends partly on the date of redemption and partly on the expectation that, as predicted by Mr. Bonar Law, the Government would never again offer such liberal terms.

two sources will be made as productive as they might be. As regards the small investor, the War Savings Certificate is preferable both to the State and to the investor. It is better economy, and the interest is not paid until after the war. If, however, the small investor does not like to defer the interest for so long and prefers the 5 per cent. of the new loan, surely it would be easy to devise some mode of payment of a continuous kind.

With regard to borrowing from the banks, it seems as if a longer time were needed before the scheme is likely to be understood by the small or moderate investor, who knows nothing of "bank rate varying," and has a healthy dislike of borrowing even if good may come of it to his country. Perhaps the greatest merit of the borrowing scheme is the gentle intimation it affords of the way in which the alternative may be carried into effect if and when it comes.

From the bankers it is most gratifying to learn that at last they are becoming alive to the possible dangers of inflation. Altogether it seems as if the whole country were beginning to realise that the greatest war on record may involve the greatest sacrifices. Let everybody take his last dip into the lucky bag of bonuses provided by the generosity of the new loan, and provide his own insurance against the alternative of compulsion. Very properly the Chancellor of the Exchequer has said that the free-will offering will be fully taken into account in distributing the compulsion.

CHAPTER XXXVIII

FOR AND AGAINST A FORCED LOAN

(*February* 15, 1917)

THE possibility of a forced loan has already come within the range of practical politics. With the increase in expenditure and the development of the most critical stages of the war a forced loan may be a matter of months. The arguments for and against should be duly weighed whilst there is still time for deliberation. The extent and the degree of the compulsion will vary according to the estimate of the advantages and difficulties. It will vary also according to the success or failure of the voluntary method.

It is easy to show that there is nothing in the principle of a forced loan that has not already been conceded in other matters at least equally important in the present war. The analogy of the conscription of life is obvious. So is the increase in taxation far beyond the normal peace limits even of recent times.

The opposition between taxation and compulsory borrowing is not one of principle but of degree. What the Government takes by taxation it does not give back at all except in general benefits which are not proportioned to the contributions of the particular payers. What the State takes by a forced loan is supposed to be restored after a time with or without interest. If the time is long, and the inconvenience to the forced lender very great, the difference with taxation is practically of little importance.

If the forced loan is repaid in a short time—suppose, for example, it has first claim at the end of the war—it may afford a convenient mode of softening the hardships of taxation.

A good deal of wild talk has been indulged in lately on the desirability of taking from the rich so much as to leave them with only the very moderate competence of the average man. The idea of equality of taxation at the root of this levelling is that everybody should be left equal after all the proposed socialistic pruning and lopping had been accomplished. We do not want a social revolution of this kind in this country at the critical stage of the war. It is in Germany that a social revolution of another kind seems (to us) desirable. In the matter of the conscription of money, as in other things, it is our nature to proceed on methods of compromise and adjustment, not by simple confiscation.

Taxation after a certain point is unjust to the present race as compared with future generations, which will have most of the benefit of the war. Of course the full resources of the country must be used to the utmost, but it will make no difference to the immediate use if a promise is given that of the compulsory takings by the State a part will be returned after the war. All that this means is that after a point a forced loan is preferable to the further increase of taxation.

It is preferable also to the reliance on voluntary loans if such loans have to be paid for at too extravagant rates of interest. Before the present loan was offered the idea had prevailed that the Government must go on paying increasing rates in every new borrowing. This idea was false economically and wrong morally. The rise in the rate of interest was not necessary to attract new money. There was the absence of other modes of investment, and there was patriotism. Apart from these considerations the higher rates were never high enough to attract the unpatriotic minority who looked entirely to their own interests. To these people the more they saw the wealth of the patriots going into the war loans the less they saw there would be left to go into the other things. The other stocks would fall in price, and offer better and better bargains. The analogy with the unpatriotic providers of labour is exact. The more the patriots volunteered for the war so much the

fatter would be the places that were left. A remedy was found in the matter of labour, and a similar remedy can be found in the matter of money. The compulsion of labour was adopted only gradually—so let it be with money.

The time has come when an expedient suggested to the former Chancellor of the Exchequer might, perhaps, be put in practice. Let everyone who makes any investment of money in buying stocks, or who lends money in any form, be compelled to invest in War Loan a proportionate amount. To begin with the proportion may be small and the field narrow. With increasing needs both may be enlarged.

We may borrow from the *Times* a glaring example. There are the professional money-lenders who advertise their philanthropy in the columns of the papers. They are prepared to lend large sums without security. Where would be the hardship if for every loan at 50 per cent. to the foolish they were made to advance a similar amount to the wiser Chancellor of the Exchequer at 5 per cent.?

We may take another example from the other extreme—from the owners and employers of the great capitals which have been used in beating our plowshares into swords and making ready for the great decision: "Multitudes, multitudes in the valley of decision: for the day of the Lord is near in the valley of decision."

In war as in industry our labour would have been helpless without capital. Nothing could be more unjust than to suppose that the great capitalists of this country have set themselves, like mediæval usurers, to extract the utmost from the necessities of the people. But if our capital has saved the nation it has also earned good profits. Even after an equitable excess has been taken by the State, the balance is beyond the normal range of peace. It was stated recently by Sir Edward Holden in his able survey of the monetary situation that a large part of the thousand odd millions of our floating debt, in the form of Treasury bills, was held by the makers of war profits, and he advised them to put £500,000,000 into the new loan. In this case not very much compulsion ought to be needed. Perhaps the

proper limits of special taxation of war profits have already been reached with due regard to enterprise and efficiency. Perhaps not. In any case there seems no great hardship if the Government, instead of paying $5\frac{1}{2}$ per cent. for the temporary use of the surplus war profits, should pay $5\frac{1}{4}$ per cent. for a longer period, especially as the stability of the long loan is supposed to be assured by the Sinking Fund.

Although the Stock Exchange has suffered severely from want of business, the records show that some of the makers of war profits are finding investments at attractive prices. Why not? But why not also be made to put a part in War Loan?

There are, however, two great dangers in general compulsory borrowing as compared with a great increase of taxation. There is the danger of lessening economy. There is also the danger of increasing inflation. Taxation of necessity enforces economy on the people, and after a point the difficulty of getting money by taxation imposes some check on Governmental extravagance. If, however, the Government can get as much as it wants by compulsory borrowing, one of the great checks on public extravagance is removed.

Our experience in the present war has shown that economy has been disregarded to such an extent that public extravagance has become a habit. Even at this stage of the war, in trying to arrange for national service on a voluntary basis, one leading idea seems to be to provide a minimum wage and additional compensation in case of transfer to another place. A legal minimum wage has hitherto been regarded as an ideal unattainable even in peace. With difficulty the plan has been realised in some of the sweated industries. Again, it is provided that everyone employed in some new calling is to get the standard rate. But how will it be possible to ensure the standard efficiency? It is easy to see that voluntary national service under bureaucratic control will involve an increase of cost as compared with peace, and also will tend to increase the consuming power of the masses reckoned in money.

The people who clamoured most for the extension of

Governmental management are now alarmed at the enormous and increasing expense of the all-pervading bureaucracy. How much of the money raised by loans and taxes really finds its way to the ships and the men and the munitions? How much is wasted by the multitudinous officials many stages removed from the actual conduct of the war? We are told that in London there is a famine of typewriters. There are not enough machines, and there are not enough young women trained to work them. Is the war to be won by typewriters, dead or living? The biggest and best hotels and mansions are taken (and adapted) for the comfort of non-militant staffs. Everybody knows of somebody who is earning more than he ever did or ever will again, except in what is called war work. Much of this so-called war work consists in the management of human beings. People are to do what they are told, and therefore they must be told what to do, and somebody must see that they do it. Anybody, it seems, can manage human beings. For such employment no particular skill is required. The management of cattle and sheep and horses and even pigs requires some training. Even in the present dearth of agricultural labour the farmers will not entrust their live stock to untrained war workers. Our Government is not so particular with its human live stock. This, then, is the first great danger of compulsory borrowing—the danger of an increase in public extravagance. The second danger which is closely connected with the first, is the danger of inflation.

That the country is already suffering from inflation is now evident to the least observant. The foreign trade returns for January again show lessening quantities, but rising prices. The adverse balance arising from the excessive prices of imports is still one of the chief troubles of our financial authorities. The magnitude of this adverse balance is largely due to the inflation of prices in this country.

The banking position is also significant of inflation. The records of banking are too prosperous and the real material foundation is too narrow. There is no reason again to press this point, as it is now admitted by the bankers them-

selves. They have stated that they do not wish to encourage borrowing for investment in the War Loan unless the borrower means to make good by real economies in a limited time. Borrowing in the German method can only lead to further inflation and a further rise in prices.

Inflation is one of those human errors of which the saying is true that it is never too late to mend, with this interpretation, that bad as it is, it may always get worse. The only remedy is to stop. It is time to stop when prices have doubled since the beginning of the war, and are still rising.

If, however, the method of a forced loan is adopted, many people may think it necessary to borrow from the banks who would not do so under the voluntary method. In order to make the forced loan successful the Government might even compel the banks to advance on certain approved security for the period of the loan. In this case the inflation of prices must be increased. Such is the teaching of the old financial authorities, and such is also the warning of the present-day bankers at their latest general meetings.

Therefore, once more the end of the sermon is that everybody in his own way, to the best of his strength and courage, should practise economy. If the economy is made in the necessaries of which there is a limited supply so much the better, but such economy cannot be nearly sufficient to meet the demands of war expenditure. Let it be clearly understood that any kind of economy that puts more money at the disposal of the State is so far beneficial.

For the encouragement of this very necessary economy no better example could be offered than by the Government itself. Any action of the State is always writ large. Why should the average man pinch his family or even himself if the proceeds are to be wasted in things that can only hinder the conduct of the war? In the present emergency any waste of labour of any kind is as serious as the waste of material. We have lately put up an image of Mr. Gladstone. We may take to heart one of his sayings that deserves to become proverbial: "Good finance consists more in the spending than in the collecting of revenue."

CHAPTER XXXIX

THE FOOD SHORTAGE

(*April* 10, 1917)

In the wisdom of the ancients, Fortune was always regarded as one of the greatest, if not the greatest, of the powers that govern human affairs. In the fair humanities of old religions, Fortune was a most beautiful goddess who must be instantaneously seized by the lock of hair in front before she could turn and flee away and offer her bald pate to the vain pursuer.

The same idea has been expressed in the poetry and the proverbs of all nations, and history is full of examples of lost opportunities and vain pursuits. In war the power of Fortune and the need for instant seizure of the happy chance has been recognised by all the greatest captains. And it is not only in the battlefield that quick decisions are needed for success in war. The recognition of this truth at the end of last year led to the compression of the Cabinet and the freeing of its members from departmental work. It led also to the appointment of dictatorial controllers. It was hoped that by these devices anything that had to be done would be done quickly. Hitherto the speed has not been astonishing, except perhaps in the multiplication of officials. But time and tide wait for no man.

These general reflections have been aroused by the present shortage of food in this country. It is a time in this case for rapid decision. Fortune has already begun to turn her head. Of the fact of the shortage there can be no doubt. There are no figures available, but the suppression of the figures is itself ominous. According to the speeches of responsible statesmen, there are not enough breadstuffs to

last till the next harvest. According the the naval authorities, the importation of the necessary amount is not certain. No country can resist starvation beyond a certain limit. The ignominy of a peace forced on us by Germany through cutting off our overseas supplies would be unspeakable, and the real disaster to world-civilisation would be as great as the national shame.

No doubt the shame might be partly hidden by excuses. There is, for example, the historical excuse going back to the repeal of the Corn Laws. For the last seventy years our agricultural policy has been adverse to the production of grain. But it is doubtful if any Governmental policy could have maintained the arable acreage in the face of the opening up of new countries and the unexpected improvements in transport. For thirty years the repeal of the Corn Laws only prepared the way for the contraction of the home supplies. The actual contraction on a serious scale only began in the last quarter of the nineteenth century.

The real corrective to this loss of self-sufficiency in the production of essential food supplies was found in our power of the sea. The argument was that so long as we had the command of the sea we could draw supplies from the ends of the earth, and that our supplies would be surer than if we relied on our own resources under our own climatic conditions. This argument was perfectly valid. The recent snowstorm ought to be a useful reminder to our people that our climate is variable. The history of British agriculture over centuries shows that oscillations have occurred between very high and very low prices according to the goodness or badness of the seasons. The famine prices of the Napoleonic wars were due to a succession of bad seasons. The country at the time, under normal conditions, was self-sufficing. In fact, for more than a century before the Napoleonic wars the country had been more than self-sufficing in normal years. The bounty given on the export of British corn in this period is the most famous of all bounties. In years of scarcity the bounty was suspended.

In the Napoleonic wars the import duties were in general not operative if the price of corn rose above a certain height. The main cause of the high prices was the bad seasons in England, and whenever a good season occurred prices fell below the normal. In 1812 the price of wheat was 126*s.* 6*d.* per quarter; in 1822 it was 44*s.* 7*d.* After the repeal of the Corn Laws, and after the great improvements in transport in the 'seventies, British weather ceased to be the governing factor in the price of British grain, and in some of the worst seasons on record there was practically no compensation in the rise in home prices.

British weather is not only very variable, but as yet has not been brought under any law of averages of any use for practical agriculture. For a long time, in accordance with some lunar theory or superstition, it was believed that nineteen years would see a complete cycle of weather, and a nineteen years' lease was supported on that ground; but Thomas Tooke, the great historian of Napoleonic war prices, showed by his researches that a hundred years at least would probably be required to reduce to a fair average the inequalities of the seasons.

No one supposes that the present war is likely to last a hundred, or, for that matter, even nineteen years, and yet in the belated provision for abundance of home-grown wheat for the next year or two very little account is taken of the weather. The farmer is guaranteed minimum prices on a falling scale, which is a very different thing. British weather not only varies from time to time, but very often from county to county. The method of minimum prices suggested by Lord Milner's Committee would have been the cheapest insurance ever effected for the encouragement of home-grown wheat; but there was no one ready to seize the frontal lock of Fortune, and ever since agricultural policy has been a kind of moving picture of a panting John Bull in a vast hurry pursuing a classical bald-headed goddess.

If the warnings of our responsible governors are to be taken seriously, and if the country is within range of possible disaster from food shortage, our food policy ought to be

governed by military considerations and our supplies made sure by military methods.

British military methods in the present war fall into two classes—the methods, namely, of persuasion with over-payment, and the methods of compulsion with under-payment. In the ordinary conduct of the war we are still trying both kinds. We are still raising the war bonuses of the stay-at-homes and sending them in case of need our best public orators to compose their feelings, and at the same time we are casting wider the net of compulsion and handing over the captives to war rations and the raucous drill-sergeant.

If it is really necessary to stimulate home production to prevent military disaster or an ignominious surrender to Germany, then instead of a falling scale of minimum prices we ought to offer a rising scale of bounties on production. Promise the farmer so much extra for every extra quarter actually forthcoming. If for any reason the method of bounties does not suffice, or if it is not thought equitable, then it should be supplemented by the method of compulsion. The nation at war has the first claim on the use and the produce of the land. Such a doctrine is not revolutionary, but the very corner-stone of political society.

But at the end of the third winter of the war it is too late to rely simply on any great increase in British production. Apart from the hazard of the seasons a system of agriculture cannot be changed in the twinkling of an eye. Production depends not only on bounties or compulsion as the case may be, but on skilled labour and specialised capital and material. The supplies of both, however, are limited. Both are required for other war purposes. And we can never be sure that a wet summer or autumn will not destroy the greater part of the expected crops.

The aim of the present argument is not to show that any attempts to increase our home supplies are of little use. On the contrary, to increase home production we should be justified in resorting to greater bounties and also to greater compulsion than have yet been tried.

But the point is that in any case we shall have to rely very largely on overseas supplies. In the matter of national food in a war of endurance assurance ought to be made doubly sure. In the very grave speech made by the present Prime Minister after two months of office, he said that unless we were to adopt the most stringent measures regarding the imports that are admitted and in the consumption of those imports, we are faced with disaster. This statement was not a side remark made under the play of oratorical emotion, but the reasoned conclusion of a long argument bristling with official calculations.

Once before, under the previous *régime*, the Government made a long list of restraints on imports and of proposed taxes on imports. The restraints were loosened by licences and the taxes were whittled away by trade interests. The full effect is seen in the record magnitude of the imports of last year. The growth of imports that used to be the glory of Britain has now become our shame. The only reasonable sequel to the grave warnings of the Prime Minister is the great and continuous displacement of other imports to make room for additional cereals. In spite of the world shortage there are probably still supplies obtainable by this country at a price, and for the present there is enough of tonnage and power of the sea to ensure delivery.

It is, perhaps, not yet too late to try the method of public granaries. The method was advocated even in the seventeenth century, when the country was in normal times self-supporting. The idea was much in vogue before the present war. It is an essential part in the new economic system of Central Europe, made popular by Dr. Naumann. Until other countries actually prohibit the export of grain, the richest and most eager customers will get supplies, even at the expense of semi-starvation in the corn-lands themselves. But if it is not too late, there is no time to be lost. Whilst we still have the ships and the money. we ought to make sure of the grain. There are already statistical reports of shortage in the United States ; and Argentina is said to have already resorted to prohibition of exports.

Even if the home production is increased to the utmost in the time available, and even if the weather is favourable, and even if we can buy abroad, and even if we can bring home the surplus still available, and even if (fifthly) we have the sense in time to store up the new supplies, the old standard of living will have to be contracted. We were assured by the Prime Minister that if the people assented to the restrictions on consumption suggested by the Government, all would be well. But in a matter of national life and death, with Germany as the would-be executioner, we need a surer guarantee than the voluntary abstinence of a people pampered by war bonuses.

The natural economic restraint on consumption of any kind is a rise in the price of the article concerned. Everybody is supposed to know that the prices of things, if left to themselves, depend on demand and supply. If the quantity demanded is greater than the quantity offered, the price rises until the weaker demanders are thrust out.

In the case of necessaries (natural and habitual) any rise in prices has little effect on the quantities demanded until there is a serious lessening of spending power. Accordingly, it follows that if with every rise in prices there is to be a new war bonus to meet the increased cost of living, this most vital of all checks on consumption is relaxed. Yet every day we read of threatened strikes averted by new war bonuses.

The old economic principles which were neglected and reviled in the fictitious prosperity of public extravagance on borrowed money are once more beginning to assert their rude elemental strength. People are being forced to measure national prosperity, not in money, but in the necessaries and other things that the money will purchase.

The fall in the purchasing power of money, or, what is the same thing, the rise in general prices, goes on increasing at an increasing rate. The index number of the *Economist*, which is the most popular measure of the rise in prices, last month not only surpassed all former records, but made the greatest advance of any month in the war. Taking the

average of prices of 1901–05 as 100, the index number for the last of July, 1914, was 116·6, and for the last of March, 1917, the figure is 240·9. Expressed in the simplest terms this means that prices on the average are two and a-half times as high now as in the first five years of the present century. It does not mean that we are two and a-half times as prosperous, but so far quite the contrary.

If the country is to escape from disaster—the word is getting as common as the wolf in the fable—the national saving must be a real saving in consumption, and not a mere money saving of war profits and war bonuses and war credits.

And the saving must be a saving by the masses for the masses. This is a hard saying, but, as all the other belligerents have found, war is a hard master. One of the greatest of all our economic mistakes in the present war was to use the occasion for raising the pre-war standard of living by the expenditure of money borrowed for the conduct of the war. Germany from the beginning began to practise the difficult art of lowering the national standard of comfort. In France, Russia, and Italy the people have felt from the beginning the real burden of war in reduced consumption. It is now our turn.

CHAPTER XL

GLUTTONY IN WAR-TIME

(*April* 30, 1917)

"To have respect of persons is not good; for, for a piece of bread that man will transgress."—PROVERBS xxviii. 21.

IT is quite certain that voluntary rationing can never succeed unless our people as a whole realise the national danger. How can the people know unless they are taught, and how can they believe when their responsible teachers tell them smooth things and show, by their own example, that voluntary avoidance of waste is an impracticable ideal?

"It is not good to have respect of persons." The words of my text were suggested by reading in the *Times* that on the luncheon tables of the House of Commons the waiters had to sweep up a quantity of wasted bread. Perhaps this incident will be explained away. Perhaps the House of Commons will be the first public body to abolish the use of bread at lunch and dinner. Perhaps not. The reluctance of the House of Commons to follow the example of the King in the matter of drink has not yet been explained away.

It is no doubt quite true that the amount of bread actually consumed or wasted by our legislators is negligible. But the votes they give and the examples they set are by no means negligible. They give plenty of advice to the "prosperous" classes, and tell them to eat less bread so that the poorer masses may have a sufficiency. But they never venture to draw the line of "prosperity." Where does prosperity end and poverty begin? What is the standard of comfort which is really an irreducible minimum? Our legislators have become so accustomed to recommending

war bonuses in proportion to the rise in the cost of living that the idea of a general fall in the pre-war standard is quite unthinkable. Great play is made with the efficiency of labour and the economy of high wages, and exceptions are added to exceptions until voluntary rationing of bread fails altogether. And yet the Food Controller tells us that unless the voluntary rationing of bread succeeds in the next six or eight weeks compulsory rationing must be enforced. But he also says that compulsion is so difficult that another effort ought to be made to save the voluntary system.

That is the reason for plain speaking. "To have respect of persons is not good." The masses, too, are persons—persons with mouths. The other day, in a walk in the outskirts of the City, I picked up four pieces of bread which had been thrown away half-eaten. They weighed two ounces—just the amount suggested as the bread ration for a meal. This experience is only one sample. Many instances on a much larger scale are recorded in the papers, and every acquaintance is ready to cap my little story with a worse. "Nobody," said Adam Smith, "ever saw a gentleman drunk with beer." The gentleman chooses a more expensive kind of drunkenness. In the same way nobody ever saw a gentleman throwing away in the streets half-eaten pieces of bread. The gentlemen of the House of Commons leave their unfinished pieces on the tables.

Who then are the people so unprosperous that they only get a bare sufficiency of bread, and have none to waste and can buy no other substitute? Dr. A. L. Bowley, the well-known statistician, gives the following pre-war figures of the ordinary expenditure of certain families. The poorest of London households just able to pay their way, out of a normal weekly expenditure of 21*s.*, spent on bread and flour 3*s.* 1*d.* Out of 23*s.* 4*d.* the labourer in provincial towns spent 3*s.* 3*d.*, and out of 41*s.* the artisan in provincial towns spent 4*s.* on bread and flour. The average price of the quartern loaf in 1914 before the war was $5\frac{1}{2}d.$, so that in loaves the consumption per family was $6\frac{7}{11}$, $7\frac{1}{11}$, $8\frac{8}{11}$. From

other figures in Dr. Bowley's tables it appears that the artisan with 41*s*. per week spent 25*s*. on food, of which only 4*s*. was on bread and flour. His family used a little more than two loaves a week more than the poorest Londoners and nearly two loaves more than his fellow provincial labourers.

The question is—Was the artisan with the pre-war standard of 41*s*. a week prosperous? In case of need could he have reduced his bread ration? Another question is equally pertinent—Supposing the quartern loaf had been doubled in price so that he would have had to spend 8*s*. instead of 4*s*. out of his 41*s*. to get his former allowance, would he have taken less bread? The answer is probably not, and that if other foods, *e.g.*, meat, had risen in price equally he might even have taken more bread or flour.

The war has just doubled the price of bread (to say nothing of the fall in quality) and has also raised other things. But the war bonus has raised money wages (especially with the family as unit) and rents have been kept down by the law. Is it likely that the prosperous working class family of the 41*s*. standard before the war will now reduce its consumption of bread on the invitation of the Food Controller? And if the line of prosperity is to be drawn above, and much above, the artisan standard, then in the name of arithmetic how is it possible that the voluntary restraint of the prosperous classes shall suffice to give the poorer the full pre-war standard?

If we are not to be forced to a shameful peace by lack of bread, the masses of our people must be made to understand the danger. If a dozen families taken at random from our people were submarined actually and were put in boats with limited food, they would submit to the necessary rationing with resignation. Not one would throw away the precious bread, and not one would steal from the common stock. Why should millions of families not conform to the sample to escape the German peril? The only reason is that they do not really believe in the peril. And they never will believe in it if they are constantly told that there

is no need for alarm if only they will be a little careful. Why should they not be alarmed? What is the use of giving the alarm if people will not take the alarm? The sooner people are alarmed and the more they are alarmed so much the better. Taken in samples they are all decent people of good courage. If masses of decent people regularly waste their daily bread (after regularly praying for it), or if they eat the share of other people, it is because they sin in ignorance. They are gluttons without knowing it.

The war has in many ways restored the moral health of the people. Some of the old virtues have regained their lost power. The opposite sins and vices have been rooted up or cut down. Before the war some of these ill weeds had been so cultivated and cultured that they were regarded as prize flowers. Sloth, for example, a rank old mortal sin, in its most cultured forms was greatly admired by all classes from the highest to the lowest. The war has restored the dignity of labour. To find some kind of war work is the highest ambition of the idle. The feeling is real. Ordinary men and women who cannot fight are ready to do anything to help on the war. There are exceptions, just as there are people who are colour blind or "no wise." The new cult of labour means so far the digging up of sloth. A real sluggard is now no longer a prize bloom, but a weed.

But one of the greatest and the rankest of the old mortal sins is still flourishing, and in many of its forms is still greatly honoured in the observance. Gluttony. The warning in my text seems specially aimed against gluttony. "For, for a piece of bread that man will transgress." How far, then, would he go on the wrong path for continued good living? In preaching against gluttony for the period of the war no respect must be paid to persons. We are all of us miserable sinners in this matter, often without knowing it. The old definition of gluttony in the "Poor Man's Catechism" is "an inordinate desire of meat or drink." According to the old masters of morality there were five chief kinds of gluttony. The curious reader will find them all described in Chaucer's "Parson's Tale" (*sub voce gule*). The first kind

is drunkenness—but there are four others. Each of the five is represented as a finger on the devil's hand. In the old treatment gluttony of meat (in the old sense of food) and gluttony of drink were always classed together. During the war excess of drink has been restrained, but instead of the nation curbing its eating, what was saved in drink seems to have been wasted in food. What we have to realise is that just now excess of eating is as bad for the soul of the nation as excess of drinking. List to the old exhortation: "Excess of meat and drink nourishes almost all diseases of the body as well as of the soul. Other accidents may threaten but this destroys. For gluttony kills more than the plague or the sword."

The words are directed to the individual, but the nation is made up of individuals. And the words are literally most truly applied to the nation in our present case. If we go on at our present rate of consumption we shall lose the war. That is the message of all our responsible statesmen, though unfortunately the habit of saying smooth things has become so engrained that the warning is lessened by the usual flatteries. There is no immediate danger—the real danger will come in two or three months. It will.

The issues that depend on our food supplies are so vital that assurance ought to be made doubly sure. The risks of failure are so terrible that excess of caution is what is needed.

It is far better that the people of this country should realise the possible danger to the fullest extent—far better that they should be alarmed—than that they should be made comfortable by calling to mind all the possible alternative chances.

Even suppose that, after all it should turn out that the Food Controller has been rather too stringent, or that thousands or millions of people in these islands have eaten less than they might have done—that is to say, that they have lost so much happiness in pleasures of the table and even suffered some of the pains of hunger. Where is the real harm when the balance is struck? Even if the war is to end before the autumn, the food difficulty will not be

over. Any store of any kind of food will be most precious next winter.

The case is really too clear for argument. It is not argument that is needed, but moral courage on the part of every kind of teacher and speaker and writer to tell the people that under present conditions too much eating is a national danger. There are in the land all sorts of organisations that might be used to tell the truth. Let the temperance people remember that excess in drink is only half the sin of gluttony, and that just now the other half, the excess in feeding, is the more dangerous. Let the promoters of the war savings tell the people that the saving that is now most needed is not the saving of money, but the saving of food. Let the teachers in the schools make the children see that every piece of bread they throw away is helping the Germans. There is not a social or religious institution of any kind that may not find an occasion to repress gluttony. The great thing—the essential thing—is to pay no respect to persons. When it comes to the saving of food every mouth counts. If a few thousand zealots were to starve themselves to death, it would be of no avail if the rest of the nation went on eating as usual.

The logical outcome of the argument is that the greatest of all organisations—namely, the State itself—should use the greatest of all arguments—namely, compulsion—to make effective this particular kind of insurance against the great national peril. Such is indeed the true conclusion. But in State action so far-reaching the consent of the governed is more than ever necessary for success. Regulations may be evaded—the army of food officials may be unfitted for so hard and unusual a task. Even German docility and German organisation have only partially succeeded. We are brought back always to the hearts and minds of the millions of living beings who make up the nation. If the people do not see the need for the restraints and the reasons of the restraints they will not submit to the daily discomfort. Everybody wants to do his bit. Everybody can do a bit more by eating a bit less.

CHAPTER XLI

GLUTTONY IN WAR-TIME

(*May* 19, 1917)

II *

WE have already adopted compulsion in regard to the waste of food. The penalty for such waste is £100 fine and (or) six months' imprisonment. The penalties may easily be raised. The difficulty is to enforce the penalties except with the intelligent consent of a willing people. Penalties of any kind are preventive, not in proportion to their severity but in proportion to their certainty, though this elementary political wisdom is constantly forgotten.

And yet the simple truth is that if the edict against waste were strictly interpreted and carried out with certainty the difficulty of compulsory rationing would be overcome. Anybody who eats more than a reasonable quantity of food wastes that food. What is reasonable is laid down from time to time by the Food Controller or by Royal Proclamation. Could anything be more simple? The law against gluttony, though occasioned by the defence of the realm, would be supported by all the authorities on health, morality, and religion. There is only one obstacle. The people do not see the necessity.

We are always brought back to the need of public enlightenment on the facts. But in any statement of facts we must be very careful not to encourage the Germans or discourage our own people. Under these very proper limitations we are told officially that if the people in the main accept the advice of the Food Controller, and if they are judicious in their consumption, we shall survive to the coming harvest

* See above, Chap. XL.

without any real privation, and that by 1918 we shall be self-supporting.

It is assumed in this statement that if we can only get over the difficult months to the coming harvest all serious danger will be past. Suppose, however, that the harvest is a good deal below the average through bad weather. We cannot forecast the probable weather, but we are warned by the past not to be too confident. Here are some samples of British weather within the experience of many people now living. The samples are estimated by the yield of wheat per acre over the thirty years from 1849 to 1878 in a table drawn up by the late Sir J. Caird. The average for the period was 28 bushels per acre. If we take this as represented by 100, so as to put the percentages in a convenient form, we find that the yield in 1849 was 123, or 23 per cent. above the normal. But in 1852 the figure was 79, and in the next year only 71. Again in 1870 the yield was 112, but the figures for 1875–76–77 were 78, 76, 74.

The point is that we ought to allow for a good margin of safety in the matter of the weather. The potato failure of last season and the world shortage of cereals ought to be fresh in the minds of everyone. So far the winter and spring of the present year bear a dismal resemblance to 1816, which is described as being the most inclement year since 1799, the harvest in consequence showing a lamentable deficiency in quantity and a miserable inferiority in quality. "Indeed, all that had been saved of the crops was in so damp a condition as to be unfit for immediate use" (Tooke's "History of Prices," vol. ii., p. 14).

When we speak of self-supporting independence in 1918 it is well to realise what is really meant by independence in a country such as this.

Reference may again be made to the period of our last great war, 1793–1815. Before the war the country was not only normally self-supporting, but was even an exporter of grain. For the greater part of the war period the seasons were very bad. In 1808, however, the harvest was good, and there was actually a balance of exports of grain from

the country. But the occurrence of this and one or two other good years only brings into stronger contrast the effects of the bad seasons in general. Here is an example of our "independence" in 1801. In that year, just before the harvest was secured, the price of wheat in London rose to 180*s.* per quarter, and for four weeks the quartern loaf was 1*s.* 10½*d.*—just about double of our present price.

Perhaps it will be said that, in spite of the bad seasons, we fed our people and carried on the war for another fourteen years after 1801. Give us now the same independence (it may be said), and we also can carry on. But again we have to remember that in 1801 the population of Great Britain was only about 10½ millions as against 40½ millions by the Census of 1911. And we have to remember also the methods by which the people were fed in the last great war. Wages were so low that it was only by supplementing them by the poor rates that the population was kept alive. The heroic character of the endurance of our people in the last great struggle for European liberty can only be realised by considering the misery of the masses. There are, it is true, no full records of wages and of workmen's budgets and of the rise in the cost of living such as are now furnished by the *Labour Gazette* of the Board of Trade. On the whole, however, it may be said that in the last great war the condition of labour fell far below its pre-war level, whilst up to the present in this war the general condition of labour has improved compared with our pre-war level. How, then, shall we bear the test of real privation if it comes as a thief in the night before the next harvest? How shall we carry on in the winter if this expected harvest is deficient?

With regard to our overseas supplies, the reference to the previous great war period is not so encouraging as is generally supposed. In spite of our command of the sea our mercantile marine suffered severely, as is shown in an interesting paper by Professor W. R. Scott in the current number of the *Scottish Historical Review*: "The losses from all causes between 1803 and 1814 were very great. At least 40 per cent. of the British tonnage of 1803 had disappeared

from the British registry. . . . It was only the new construction that saved the situation."

Whether we look to home production or to overseas supplies, the lesson from history warns us that unless we allow a good margin for safety we run the risk of putting an unbearable strain on our people.

If the margin for safety is to be obtained by diminished consumption a very strong moral effort will be required all round. The effort must be all the stronger owing to the artificial prosperity caused by the lavish war expenditure up to the present time. In every industry connected with the war the ruling idea seems to have been that the pre-war standard of comfort ought to be raised. It has been raised. Whether such an improvement was equitable, desirable, or even necessary, is not now the question. The thing has been done. Numbers of families since the war began have consumed more than they ever did before. How can they be brought to consent to a reduction of one quarter below the pre-war standard in their staple food?

The *Times* has given prominence to what is entitled a strong labour manifesto. The essence of its strength is given in large lettering. It is a demand for a cheap loaf. The loaf is to be reduced to sixpence. Such is the outcome of all the bonuses to meet the rise in the cost of living. To get the benefit of the bonuses the cost of living must now be reduced to the pre-war level. To cheapen bread in this way is to lessen one of the few effective restraints on its consumption. It is also demanded in this manifesto that the cost of the loaf above the sixpence should be provided by the State as part of the expense of the war. As if the expenditure on the war were not already large enough without giving outdoor relief to the whole population. And all the time these fresh demands are being made for State aid any tax that is supposed to fall on the working classes is resisted as inequitable. The cheapest seats in the picture-houses must not be taxed at all. We seem to be setting up as our ideal the proverbial bread and circuses of the degenerate Romans.

Another example is more disturbing, because it is expressed, not in words, but in deeds. At the most critical stage of the war, when a maximum effort is needed, not only for guns and munitions, but to build and arm the very ships that are to bring the grain for the sixpenny loaf, we read of labour unrest and strikes in the most vital industries. So serious is the condition supposed to be that the inciters to unrest are warned that they are liable to penal servitude for life. If the penalty were far less severe and far quicker in coming we might have some hope. Experience suggests that the difficulty will be got over by a new bonus either in money or in relaxed control.

The outlook for a great moral effort is not flattering. Can the nation be awakened in time to meet the danger? The time is very short and the flesh very weak. The habit of being crammed with distressful bread (or less distressful food) is hard to break.

There is, however, one encouraging feature in the case. The kind of moral effort that is required is essentially economic. And people who are deaf to the appeals of religion or patriotism or duty will listen to a business proposition.

The particular business idea that we have to apply in this food crisis is the principle of insurance. Everybody is familiar with insurance against risks of all kinds. After the Zeppelins had visited the south-east of Scotland last year there was such a rush for anti-aircraft insurance that the offices were choked. Such was the effect of a very small practical demonstration.

If before the next harvest the shortage of food becomes acute the worst of the evil will not be semi-starvation. But without particularising other dangers—*e.g.*, a German peace abroad and industrial war at home—it is enough to take the semi-starvation itself. The burden cannot be thrown entirely on the wealthy or the "prosperous" classes. They are too few, according to the popular interpretation of "prosperous." The nation is made up of about ten million families. The rest of the ten millions will

see to it that in time of real need no one family shall escape if they know it. That is the kind of equality of sacrifice that everybody understands.

How, then, is the prudent individual—the average sample of the masses—to guard against this danger? How is he to secure his own family from the impending want? Money will not save him, for the food will not go to the highest bidder. If the staple food is short, the substitutes will soon be short also. Hoarding will not save him, for already hoarding is prohibited, and the hoarder in time of real want is more likely to lose his life than to save it.

The only method by which the individual can make himself and his family safe is by insurance. Everybody knows the principles of insurance. We make a certain sacrifice in the present to guard against the chance of a greater calamity in the future. The amount of the present sacrifice depends partly on the nearness of the danger. We are beginning our food insurance very late. The danger is pressing. We must pay higher premiums. The present premium is to lessen our eating of bread by one quarter and more or less diminish our consumption of other things. If we go on eating as usual for another month or two the premium will rise. The beleagured nation may have to go on half rations.

Most insurances have to be done on a large scale. This particular insurance, if it is to succeed, must be done on a very large scale. Everyone who saves his own quarter of bread is interested in making others see the necessity.

The only difference between this kind of insurance and the kinds with which we are most familiar is that the food insurance must be made good by actual saving of the food and not by money payments. There is nothing so very strange about this requirement in time of war. Money payment, for example, does not exempt from military service.

Have we become such slaves to money both in deed and in thought that we cannot understand or undertake any business that is not put in terms of money—money gain

and money loss? "The ants are a people not strong, yet they prepare their meat in the summer." "What a piece of work is a man! how noble in reason! how infinite in faculty! in apprehension how like a god! the beauty of the world! the paragon of animals!" The words are familiar; the moral is obvious.

CHAPTER XLII

THE INEQUITIES OF INFLATION

(*July* 11, 1917)

Everybody now is familiar with the fact that since the beginning of the war prices on the average have been doubled. Some things have risen more and some less, according to the special circumstances affecting their particular demand and supply, but the general average is about double.

Although the rise is not uniform, it is practically universal. For a long time certain customary prices were maintained by the aid of a lessening in quantity or quality. Newspapers struggled on with smaller sheets at the old penny and half-penny rates, and railways and other vehicular conveniences kept to the old fares, with a gradual fall in comfort and regularity of supply. But in the course of the progress of the inflation at last these customary prices gave way before the general flood.

The universality of the rise shows that it is not due entirely or even mainly to scarcity. There is no scarcity of earthworms, but earthworms have risen in price. The other day I asked a man who was gathering this bait for sale if the price had gone up. I have long been in search of something that has not risen in price. He quoted the prices of the worms by the handful, and by the bucketful—the prices that he obtained himself for the gathering and the prices the dealers made on the first change of hands. The worms, it seems, were sent to distant markets, and, no doubt, by the time they got into the hands of the patterns of old patience, old Isaak Walton's scholars, they would be at least double the usual price. But my friend said that though he was told the gatherers were getting fourpence in

the shilling more he had not yet had such luck. In his case the customary price still prevailed.

Let us ascend from the particular to the general. It has been proved over and over again that whenever there is a general rise in prices—from whatever cause—the rise in incomes is very uneven. The consequence is that in the distribution of the national wealth—of victuals, drink, and clothing, and all the other luxuries and necessaries—some people get more and some less than their former share. The people with fixed salaries or customary wages have to pay the increased prices, and, in fact, be content with less, whilst those who have a rapid turnover of capital with the rising prices make profits and fortunes impossible in ordinary times.

A period of inflation, in short, is most favourable to speculation and profiteering, and most unfavourable to the forms of employment under the influence of customary payments, and for which there is no special demand.

Let us again descend from the general to the particular. I was talking lately with one of the youngest captains in the army on his way to receive a decoration from the King. The conversation happened to turn on a certain demand for a war bonus of *7s. 6d.* a week. "That," said the captain reflectively, "is more than all the pay the Tommy gets, and he has to send half to his family."

Why should the non-combatant parts of the war services, the providers of the materials and munitions, receive double or treble or, in some cases, ten times as much as the soldiers who risk life and limb? The contrast between the men who do the actual fighting and undergo the strain of preparation and the men whose incapacity gives them exemption from war work and better pay for civil employment, is still more astonishing.

Such inequities in the rewards of labour are due to two causes both closely connected. One is the shortage of labour, the other the inflation of money.

The labour market is depleted by the calls to military service. The shortage of labour forces up wages. Into this

depleted labour market steps the Government, with unlimited supplies of money, and bids for every kind of labour that can be directly or indirectly employed in the subsidiary operations of warfare. If the Government had to get the money by taxation some check would be imposed, but with unlimited power of borrowing there is no real check. The inflation of money forces up wages still more.

As the increased money wages are spent, prices go up. But some kinds of incomes do not rise at all. The pay of the soldiers and their dependants is not increased. The professional classes who are paid by salaries or by customary fees, annuitants living on the hard-earned savings of family insurances, the pensioners of the State, whether retired officials or old-age workers—all these classes receive only the same number of pounds, but every pound has only half the purchasing power. Their position is even worse, because they have to bear their share of the national taxation. When the family trust funds have to be realised, it is found that half the capital has disappeared, mainly through the extravagant rates paid for fresh Governmental borrowing.

It may, of course, be argued that all those who cannot find war work, and war bonuses, are, from the military point of view, useless mouths, and that in time of war it is only right that more of the nation's wealth should go to the real war-workers and less to the non-workers. The worst of it is that the war bonuses are not given in proportion to war merit—the bonuses increase with the distance from the front, and the allowances to meet the rise in the cost of living are not proportioned to needs but to wages.

The inequities arising from the uses of capital are even more glaring—witness Mr. Bonar Law and the tramp steamers. A large part is commandeered or put under State control, and the more necessary for the war so much more strict is the control. But the capital not under control through the shortness of supply has exceptional opportunity. And apart from such special chances of gain in a period of inflation, with prices rising rapidly at unknown rates, profits in general tend to rise. The elements of cost

also increase, it is true, but not so fast as the final prices charged to the consumer.

Take, for example, the case of meat. The Government takes nearly the whole of the overseas supplies, and pays reasonable prices in the country of origin and reasonable freights, with the result that the meat costs about *7d.* a pound. But though our home supplies were never so abundant, prices are forced up to unreasonable heights. Were it not for the general inflation in which all the customary landmarks and guide-posts have been submerged, prices could not have risen to such an extent.

We are always brought back to the root evil of inflation. The real meaning of all old monetary contracts and customs is upset. With the change in the money measure people feel as much lost as if the yard and the pint and all the other familiar measures had shrunk in unequal proportions for different uses. With the new meanings of money some people gain and others lose. In a general monetary disturbance of this kind there cannot be gains without losses any more than in betting. Some classes—wage-earners as well as profiteers—get large unearned increments, and others suffer large unearned decrements. The whole distribution of national wealth is less equitable than under normal peace conditions. Over-payment and under-payment in proportion to the services rendered are both causes of industrial unrest.

The real position may be made clear by putting it in terms of taxation. Suppose that on the outbreak of war the Government had imposed taxes on all kinds of things, increasing in amount from month to month until the taxes had reached the old value of the things themselves.

Let us suppose, in short, that the doubling in price of all things was due to taxation—that bread and meat and clothes and everything else had been taxed up to the full extent of its former value. Can we conceive of any system of taxation that could be more inequitable? Do we not remember that in the piping times of peace any taxation whatever of necessaries was supposed to be altogether

wrong on account of the glaring inequality of sacrifice involved?

But prices have in fact risen just as effectively as if all things had been taxed, and it follows that unless in every case a corresponding rise in money incomes has taken place, just the same inequalities of sacrifice must appear as in taxation.

According to the old economic teaching, the principal evils of inflation are summarised in the statement that it is a most inequitable kind of indirect taxation.

It may well be that the whole of the general rise in prices cannot be ascribed simply to the inflation of the currency. But the inequity is none the less if, as usually happens, the inflation is associated with speculation, monopoly, and profiteering. People may bear with resignation the scarcity that is due to natural causes or the hazards of war or the act of God. It may even be admitted that high prices caused by scarcity are indirectly beneficial by checking consumption. But if certain classes, with every rise in prices get a new war bonus, whilst others get nothing, where is the justice?

A doubling of prices by means of taxation would be aggravated in its inequity if remissions were granted to the most prosperous classes, and actual bounties were given to the favoured few. We hear in these days a great deal of equality of sacrifice. When the principle was first applied in practice it was directed against the exemptions of special privileged classes—aristocrats, clergy, and others. The most glaring and odious form of inequality of taxation is found when the richer classes are exempted, and in consequence the poorer classes have their own burdens increased.

The reasoning is not altered if different examples are taken. There are aristocrats and aristocrats. If the prosperous classes are to receive bonuses in proportion to their prosperity to meet the rise in prices, and the poorer classes in proportion to their weakness are to get little or nothing, then the aristocracy of labour benefits at the expense of the lower classes. The pursuit of equality of opportunity by

the lower classes is hopeless when the aristocracy of labour are always getting new bonuses in advance.

Inequalities of sacrifice in war-time are bound to increase if the people in power—whether the power is official or economic—cleave to the notion that the pre-war standard of comfort both for labour and for capital ought to be maintained. The thing is absurd. If a large part of the national productive powers are turned into the manufacture of the wastes of war—for which there is no return, but honour and sorrow and other spiritual goods—how can there be the same amount of the material things that make up the standard comforts of peace? There is no escape from the simple fact that if some classes are to retain the pre-war standard, other classes must fall a good deal below.

The fundamental moral position is that everybody ought to expect, on the whole, to be in a less favourable position than in time of peace. War on the greatest scale is only possible with corresponding sacrifice. No man ought to make a private gain out of the necessities of his country. Not that the maxim is to be made unworkable by being made altogether unreasonable. Exceptional services in war-time, whether of labour or of capital, ought to receive exceptional rewards. But these exceptional rewards should be given for effective contributions to the war and not for accidental advantages of position.

The immorality of inequitable distribution is not the worst evil of the inflation of prices. The worst result is that the monetary inflation is accompanied by a kind of moral inflation. The moral fibre of the nation becomes loose and flabby. Material needs are over-emphasised. The land is flowing with money, and why should it not also flow with milk and honey, and beer, and all the other things that money stands for?

If the things are too dear, why not give the people more money to meet the rise in prices? If it is too diasgreeable to raise money by taxation, why not borrow it? And whilst our fighting men go from glory to glory, or from martyrdom to martyrdom, our people at home go from inflation to

inflation, and from bonus to bonus, and think that exemption from active service means exemption from active sacrifice.

Whenever by a great effort of all the preachers the nation has begun to realise that the war means sacrifice—elementary sacrifice of common stomachic comforts—when the people have begun to think that they, as well as the Germans, are in a beleagured city, somebody in authority comes out on the battlements and sings with magnificent voice and spirit a variant on "Comfort ye, comfort ye my people." And then the people are comforted by being told that the Exchequer will cheapen the loaf—as if the Exchequer were a great store instead of a great drain. If the loaf is to be cheapened by the Exchequer taking over part of the cost, where is the money to come from? The popular answer is to put it down to the war account. The war has made the loaf dear, why, then, should the war not pay for making it cheap? What is the real use of a war if it cannot raise the standard of comfort?

CHAPTER XLIII

PRICES AFTER THE WAR

(*July* 25, 1917)

It was stated in the recent debate on the excess profits' duty that, in the opinion of many good judges, the level of prices would rise rather than fall at the end of the war and for some time after. Not so long ago we were told that the same good judges held the contrary opinion and were expecting a general slump.

In the course of the war there has been too much of this simple appeal to authority (varying) and far too little insistence on the principles by which before the war we attained and maintained our financial supremacy.

It is the purpose of the present argument to show that general prices after the war may be expected to fall, and that if they do not fall but are artificially maintained it will be a serious national misfortune.

Such appeared to be the thought underlying the grave pronouncement of the Chancellor of the Exchequer on the difficulties of the coming peace. He spoke of the false prosperity engendered by excessive borrowing. Not for the first time Mr. Bonar Law has refused to follow the authorities of the City. He refused to allow the rate of interest on British Governmental loans to go on rising, and his substitution of a threat of compulsion for the promise of a bonus was like a breath of the north-east wind in the sweltering heat of London.

The continued rise in the rate of interest on British Loans was, however, a minor evil in comparison with the continued rise in prices. In spite of abounding patriotism and determination to win the war we have been constantly on

the eve of most serious labour troubles. And the root cause has been the suspicion that with the rise in prices the workers lose more as consumers than they gain in money wages.

To suppose that with the coming of peace there is to be a further rise in prices instead of a fall is a dreary outlook for the masses of the nation. If the rise is inevitable it is high time that remedies or alleviations should be prepared.

First of all, what is the probable forecast for peace prices as compared with war prices when we search for reasons and not for authorities?

The natural way to answer the question is to consider the causes of the rise during the war and the probable effect on these causes of the coming of peace.

Experience has already disproved the reality or the importance of some of the causes assigned for the rise in prices during the earlier stages of the war. There was, for example, the rise in freights. It is now quite clear that, taking a broad survey, it was the rising prices which caused the rise in freights, and not the converse. It is true that the owners of the ships that were not commandeered or controlled made huge profits, but the effect on the final prices of commodities in general was not proportionate. Everybody now knows that of the rise in the prices of bread and meat and other necessaries only a small part can be assigned to freights.

A more potent cause commonly assigned for the rise in prices was the actual and increasing shortage of tonnage. Even if there were no rise in freights at all, a real shortage of supply caused by a shortage of tonnage would so far raise prices. But for the first two years of the war, so far as this country was concerned, the rise in prices could not be mainly ascribed to lessened imports through shortage of tonnage. The truth rather is that high prices have an artificial stimulus to imports and not deficiency of imports a stimulus to prices.

During the last year the bad world harvests and the obstructions to overseas commerce have no doubt caused

real shortage in food supplies and in raw materials. But there is no reason to expect a bad world harvest with the advent of peace. The probability is that, as was normally the case before the war, bad weather in one area will be compensated by good weather elsewhere. It is certain also that with the cessation of war the obstructions to world commerce must rapidly decline, and also that the shipping available for commerce must rapidly increase.

Another point is often overlooked as regards shortage of supplies of foods and raw materials—namely, the great advances made in recent years in the practical sciences bearing on agriculture and the extractive industries generally. Already we have the happy expectation of a glut of potatoes in spite of the war. Many years ago it was my privilege on a railway journey of about two hours to overhear the conversation of a carriage full of potato merchants or growers interested in a great potato market. All the way and all the time they talked of potatoes and nothing but potatoes—the kinds, the soils, the selection, the times and the seasons, and much else. Evidently at that time the book of wisdom on potatoes was a very large book, and since that time no doubt the science of potato-growing has been advanced. And this application of scientific knowledge is one of the reasons why the famine of last year bids fair to be replaced by a glut.

What is true of potatoes is true of all kinds of raw produce. During recent years there has been a very great advancement in the practical sciences bearing on all the fruits of the earth. Farmers and other growers have only partially and imperfectly adopted these scientific methods—that is to say, when we survey the world around and do not look only to the Lothians. In the United States, for example, vast sums have been spent on agricultural experiments of all kinds, and the commercial value has been demonstrated, but the practice has lagged far behind the precept. A great stimulus will be given by the coming demand of peace to the adoption of scientific improvements.

Before the war there was every prospect that in the near

future, taking a world view, the dismal law of diminishing return would be counteracted, and that a given amount of capital and labour would get more instead of less from the earth and the seas. The practical conclusion of the argument was that the prices of raw products were likely to fall relatively to the manufactured products. Once more the old belief was to be revived that in the production from the land nature labours with man and not against man if only man has the wit to guide nature aright. In the first six months of 1914 prices were falling.

With regard to manufactures in the widest sense as contrasted with raw products, taking a broad survey, there has been little destruction of the world's machinery, and it is well known that before the war any slight rise in price was sufficient to over-stimulate supply. In manufactures there was always supposed to be a law of increasing return at work.

Of course, in the determination of any particular prices we must always look not merely to supply but to demand, and the organisation by which the demand is met. To judge by the historical past, the advent of peace may usher in a wave of speculation—but the war has taught us that speculation ought not to go unbridled. If in this country in the coming peace we were to take away all restraints on profiteering, and at the same time to drop the excess profits' duty as only being levied for the period of the war, we should deserve a social outburst on the Russian model.

After all, however, the rise in prices during the war cannot be ascribed mainly to profiteering any more than to restraints on imports or to high freights. These causes may have had their share in the rise, but with the peace they will be rapidly neutralised. The root cause of the rise in prices, as is now generally admitted, has been the enormous public expenditure of borrowed money. For the most part this borrowed money has been manufactured out of inflated credit based on inflated legal tenders. The gradual progress of this inflation has been traced in these papers from the beginning of the war.

The general argument on the characteristic evils of inflation is confirmed by the Report of the Commission of Inquiry on Industrial Unrest, just published. The Commissioners are unanimous in regarding as the most important of all the causes of industrial unrest the fact that the cost of living has increased disproportionately to the rise in wages, and that the distribution of the food supplies is unequal. Not only is this the leading cause in itself, but, according to the report, its existence in the minds of the workers colours many subsidiary causes, and the feeling exists that sections of the community are profiting by the increased prices.

In response to this report the Government propose to lower the price of the loaf by throwing part of the cost on the Exchequer. The remedy is only partial. It affects the loaf and not the other elements in the cost of living. It is also only a temporary alleviant, liable in the end to aggravate the disease. It means spending more borrowed money, and again the mischief circulates.

With the end of the war there ought to be a severe check on borrowing and a severe check on any further inflation. The inflation that has occurred may or may not have been necessary for the conduct of the war. Before the next great war perhaps the question will be decided and the moral drawn. In the meantime it ought to be recognised that inflation in the coming peace would be a great evil. It will not be possible for peace to be signed one day and the public expenditure to be drawn within the limits of ordinary revenue the next, but under firm guidance the borrowing and the consequent inflation ought to be reduced as soon as possible with the narrowest limits practicable.

After the war our runaway financial machine has two very bad corners to turn. The first is the national discontent—not to say disgust—with the rise in prices. During the war this discontent has been kept from violent outburst partly by patriotism and partly by war bonuses. With the end of the war the war fever of patriotism will be abated.

And after the war, according to the agreement, the war bonuses are to come to an end. That is the meaning of a war bonus—it is for the duration of the war only. Will anyone maintain that the war bonus is to be succeeded by a peace bonus, and that wages are to go on rising for ever? The only alternative is to check the rise in prices.

We have a warning next door. The Russian revolution was not due in the main either to love of the Germans or to hatred of the Tsar, but to the intolerable economic conditions induced by the high prices and consequent abuses. A Russian writer on the war, who, like most other people, never dreamed of a revolution, deplored the grasping, sordid greed of the mercantile classes, who sometimes made enormous fortunes in a few days out of the inflated prices. The peasants at last began to refuse the paper money. They reverted to a state of barter. Long before we could reach that stage in this country the popular discontent would be uncontrollable. That is the first awkward corner—the danger, if not of a social revolution, at any rate of a succession of labour troubles that would cripple our productive powers.

The danger of the second awkward corner is not so glaring, and is not so much feared, but it is equally real. During the war we have been importing millions of pounds' worth of goods more than we could pay for by our exports. We have paid by borrowing abroad and by selling or pledging our securities, the real savings of former years. In war-time such expedients may be approved. The only matter for regret is that we have used part of these imports, paid for by war credits, not only for the conduct of the war, but for all kinds of extravagance.

We cannot go on borrowing and selling our securities in peace-time to pay for excessive imports. Such a drain must inevitably lead to a monetary crisis and a long period of restricted confidence. A chronic breakdown of credit would be almost as disastrous to national wealth as a chronic outbreak of strikes.

In any case the transition from war to peace will not be easy. But it will be much more difficult if we try to counteract the natural fall in prices on the cessation of the war by the continuance of the lavish expenditure of borrowed money.

CHAPTER XLIV

BOLSHEVISM

(*May* 4, 1918)

PREFATORY NOTE

[UNDER the Bolshevist command of the means of communication it is difficult to get authentic news from Russia. It seems certain, however, that since this paper was written the dissolution of Bolshevism under economic pressure has gone on even more rapidly than was anticipated. On the other hand, it is disappointing to find that in this country the basic Bolshevist ideas still find favour amongst certain classes with Socialist leanings. It ought to be obvious that in the United Kingdom, which depends so greatly on foreign trade and stability of credit, Bolshevism would be a greater disaster even than in Russia. Seeing that warning of disaster is not always sufficient to check social revolution it is matter for regret that so little attention is paid to the predisposing causes. The reaction after the war from the false prosperity of Governmental extravagance and inflated credit is awaited by the leaders of finance apparently with the unconcern of old Greek gods. Bolshevism has been already condemned by all the other Russian Socialists in their appeal to the Socialists of Europe (Stockholm manifesto, *Times*, July 31, 1918). The condemnation, however, is mainly political, not economic, as shown in the following question : " Are we right when we declare that Bolshevism has done nothing to apply Socialist principles and has only succeeded in destroying industry and bringing about universal unemployment and starvation ? " Economically its application of Socialist principles was most " thorough," and the result was as stated.]

Bolshevism is an economic ideal, or rather disease, that to be understood must be submitted to economic tests.

The first business of political economy considered as a practical science is to show how the people of any State may provide themselves with a plentiful flow of wealth or of the necessaries and comforts of life. Thus spake Adam Smith. The great weakness of revolutionary Socialism is that the stress is always laid on the division of present wealth instead of providing for the continued flow. "Once the things are there," as Mill said, "mankind individually or collectively can do with them as they please." How the pleasure of mankind is to be ascertained or enforced is a pretty difficult question, as the course of the Revolution in Russia has shown. But there is a deeper and more difficult question to be answered if any economic revolution is to succeed. The things that are to be divided must be there not only once, but they must keep on getting there all the time. It is easy enough to divide up any stock of wealth—the difficulty in revolutions is to renew the stock from day to day and year to year.

History shows indeed that nations have provided themselves with a plentiful flow of wealth under economic systems very different from our own. Truth is stranger than fiction even in economics—witness Peru before the discovery of America brought the miseries of European dominion. If, however, economic history reveals great diversities in the provision of the plentiful flow of wealth, it shows also that certain great principles must be observed or else the nation or tribe will lapse into misery.

How does Bolshevism stand the test of an appeal to these great principles? The first requisite of national existence—putting aside well-being—is security. And security itself is of many kinds. The most elementary security of all is protection against external enemies.

In the middle of a war against a great robber State, the Bolshevists divided up the Russian armies into sections under the control of self-elected Committees. If discipline is the life of every army, these Bolshevist Committees were

suicide clubs. Trotsky and Lenin actually put their trust in rhetorical appeals to the German rank and file to mutiny. They were seriously annoyed during the peace negotiations because the German High Command would not give facilities for their mutinous propaganda. "See," they said, "we have conscripted the wealth of the capitalists and the bourgeoisie and taken the lands of the aristocrats. It is quite simple. Let us show your soldiers the new way."

Every one knows the result. Russia under Bolshevism has no security whatever against foreign attack. A statement has been going the rounds of the papers showing what the peace, or rather the abject surrender, has already cost Russia; a third of her population, a third of her railways, three-quarters of her iron production and 89 per cent. of her coal. Such was the ransom paid to Germany, and such is the kind of security offered by Bolshevism against foreign enemies. Next in importance may be placed security for person and property within the State itself. One of the first acts of the Bolshevists was to close the Law Courts and put an end to the orderly administration of justice. It is old economic learning verified over and over again in history that even more important than the security afforded by the State against the wrong-doing of its subjects one to another is security against the exercise of arbitrary power by the officials of the State itself.

History shows, indeed, that a people may thrive in spite of a certain amount of internal disorder—witness the constant feuds of the great houses of mediæval Florence, but no nation can withstand the continuous violation of life and property by uncontrolled officials—witness Turkey-in-Asia. The effect of the insecurity due to Bolshevism is seen in the simplest case of all—namely, the cultivation of the land itself. It is stated on the authority of a *Times* correspondent long resident in Russia that the peasants will not sow more land than is necessary for their own needs. They do not know how much of any surplus will be commandeered. The peasants form about 90 per cent. of the population of Russia. They were offered by the Bolshevist

leaders the greatest and most irresistible of all bribes—a division of all the lands held by the nobles, the Church, and the bourgeoisie generally. The peasant soldiers, discipline having disappeared, promptly deserted to get their share. It was the coming of the kingdom in a form they could all understand. But no provision had been made for the orderly distribution of the confiscated lands. There was nothing but "the good old rule, the simple plan," and the Russian peasantry are now struggling with one another by districts and villages and families and units for the new land. In the meantime the confiscated lands, which alone had been worked with some of the knowledge and capital of modern agriculture, are going derelict. Russia, the great food producer, is threatened with famine. If Tsarism failed in the distribution of wealth, Bolshevism has made an even greater failure in its production.

Production cannot be carried on without trade. The greatest of all trades, as Adam Smith showed, is the trade between the country and the towns. Trade cannot be carried on without money of some kind. The first and simplest lesson in any book on money is to show the helplessness of barter. Before the Revolution Russia had been cursed by the over-issue of paper money. One of the chief causes of the Revolution itself was the discontent due to the depreciated paper. Already the peasants had begun to resort to barter through dislike of the paper money, which gave less and less command over the good things of the towns. How did the Bolshevists try to remedy this evil? How did they try to restore the stability of the monetary system without which trade is impossible and production is thrown back into the crude methods of barbarism?

Under the Bolshevists the flow of paper money has become a torrent, and Russia bids fair to repeat the notorious lesson of the *assignats* of Revolutionary France.

To complete the confusion the Bolshevists "nationalised" the banks. The process was very simple. The owners of deposits above a reasonable (Bolshevist) amount were

"considered as dead"—to adopt the phrase of an English Bolshevist—and "death duties" absorbed the whole of the surplus. In this case the evils of the destruction of internal credit became so manifest that, "for high reasons of State," the banks were again "denationalised." But the mischief had been done. Internal credit had been shattered. According to the reports of the British refugees who fled from Southern Russia by way of Siberia and Tokio, every district has its own paper money, which is not accepted beyond its own borders. It is pleasing to hear that the liberated German prisoners in Siberia have received money for their return journey in large notes which they cannot change. It is less pleasing, though no less instructive, to hear that in the Ukraine the Germans have already prohibited the use of Russian money and introduced their own forced currency.

Not content with the blind destruction of the monetary system necessary for the trade between the country and the towns, the Bolshevists proceeded to destroy the foreign credit of Russia, and with it the foreign trade. The present state of British trade with Russia is shown by the fact that even postal communication has altogether ceased. Foreign capital invested in Russia, needless to say, has been confiscated—is not Bolshevism a war on capital?—and the materials, factories, machinery, etc., have been placed under the control of workmen's committees, whose one idea is to raise wages and lower work. Our war bonuses to labour may be looked on as healthy mushrooms compared with the giant toad-stools of Russia.

The foreign public debt of Russia was repudiated. It was not a case of temporary suspension of interest under financial stress, but an absolute repudiation of the principal on the ground that the debt had been incurred by the Tsar. The foreign trade of Russia is now reduced to accepting what Germany is inclined to give for what Germany chooses to take. We may be sure that Germany will take sufficient guarantees for the investment of any capital necessary for the exploitation of Russia. Nothing but a crushing defeat

of Germany by the Allies, whom the Bolshevists have betrayed, can save Russia from becoming enslaved to German capitalism.

In the light of economic history, Bolshevism left to itself is a reversion to barbarism. The kind of barbarism which the Bolshevists wished to restore is a form of the old village community. Under modern conditions this system has two great inconveniences. It means the abandonment of all the higher forms of industrial production. It means also the abandonment of national defence. Under modern conditions the art of war involves the highest development of industrial methods.

The kind of barbarism which the Bolshevists will be forced to accept is German slavery. The process has already begun. Every day we read in the papers of some fresh humble petition by the Bolshevist leaders to their German masters. One of the latest complaints is that the Germans are deporting the people of the occupied Russian provinces in organised droves into the Russia that is nominally under Bolshevist rule. German cynicism will tell the Bolshevists, if it troubles to answer at all, to settle the newcomers on the confiscated lands. The misery of the deported people must be as great as that of the Serbians and Belgians under German rule.

The moral picture of Bolshevism in the light of common-sense morality is even more tragic than the economic. At the beginning of the war the Russian people of all the Allies showed the greatest moral courage and enthusiasm. The people, however, were ruined by the Germanised Court. The Revolution, that destroyed Tsarism and German corruption, was carried out by classes and leaders who, but for the Bolshevist extremists, would have made Russia in military and economic and moral power stronger than ever. Bolshevism did not make the Revolution under which "a glorious people vibrated again." Bolshevism destroyed the Revolution, and when Russia might have saved the world the Bolshevists poisoned her so that she could not save herself.

The Bolshevist betrayal is the greatest crime in history.

What comfort is it to the Armenians who had fled to Russia for protection to know that the Bolshevists are sending telegrams to the Germans to ask them to ask the Turks to stop the massacres?

It is reported that at last the Bolshevists have come to understand the need of a disciplined army as the basis of the security of national existence. The officers who have not been murdered have been invited (or ordered) to create a "Red" army under the most severe discipline! The French military mission has also been invited to take part in the military reorganisation of the Bolshevist "bands"—for such, alas! is the correct German description of the fragments of the great Russian army. Was ever a request so shameless when Bolshevist betrayal has put France, and with France the world, in peril of German militarism?

All that was worst in the Russian peasant has been given free play, and what was best has been trampled on. The peasants have been permitted, by the laxity of government, to make their own vodka, the root of all evil in Russia, and they have been exhorted to forget and despise the religion which was the root of their idealism. In holy Russia, before the advent of Bolshevism, on the coming of Easter, every one saluted his neighbour by saying, "Christ is risen," and the neighbour replied, "He is risen indeed." In this last black Easter can we suppose that the emancipated peasants, in honour of their Church being disendowed and disembowelled, went about with the greetings, Trotsky is risen; Lenin is risen; both have risen indeed?

Bolshevism is a terrible disease. After it has reached a certain pitch, as in Russia, the only remedy seems to be to let it run its course and wait for the natural reaction. But will Germany wait?

Whatever be the outcome in Russia, it is high time for the other nations to guard against the Bolshevist scourge. At the beginning of the great battles in France the Prime Minister took occasion to warn labour of the dangers of sectionalism. War cannot be carried on under workmen's committees. That much even the Russian Bolshevists now

admit. It is not labour only that needs the warning. With every lull in the war there has been some revival of political sectionalism. Even at the most critical stage of the present decisive battles Irish sectionalism has made its worst breakaway.

Nor is sectionalism the only danger of Bolshevism. Sectionalism may be held in check by the German peril. But after the war Bolshevism will again make its international appeal against capitalism. The revelations of the Auditor-General on the Munitions Accounts are only a beginning of a greater national audit on war expenditure. Capital is no doubt as necessary to production as are land and labour. But if the gains of capital are unconscionable, the natural outcome is Bolshevism.

CHAPTER XLV

ANOTHER YEAR OF INFLATION

(*July* 3, 1918)

Prefatory Note

[Since this paper was written I have obtained through the courtesy of the Deputy-Master and Comptroller of the Royal Mint the figures for the net issues of bronze and silver up to the end of June, 1918, in quarterly returns. (See Appendix B to this chapter.) The table on p. 108 is thus brought up to date. In Appendix B reference is made to the position of gold and silver as commodities.]

In a paper * read before the Statistical Society, June, 1917, on "The Statistical Aspects of Inflation," the principal evidences were brought under review of the relations between currency, credit, and prices from the beginning of the war. The general result was that there had been an abnormal growth in the various forms of currency and credit, associated with an abnormal rise in the prices of the groups of commodities used as the basis of index numbers and associated also with an abnormal rise in profits and wages.

After another year of war it may be interesting to give a general survey of the changes that have occurred in the financial picture. Within the limits of the present paper only a few representative figures can be given, but they will suffice.

The year has been a year of financial records—mostly bad. There are, however, signs of improvement.

* See above, Part I., Chap. V.

New records have been made in the outstanding amounts of currency notes, bank notes, and bank deposits. By the latest return (June 26, 1918) the currency notes have made a new record by passing the £252,000,000. At the end of June, 1917, the outstanding amount of currency notes was under £162,000,000. It is worth noting that no addition has been made to the amount of coin and bullion, £28,500,000, held against the notes since June, 1915, when the outstanding amount of notes was only £46,000,000.

The circulation of the notes of the Bank of England, and also of the Scottish banks, has increased by one-third during the year.

The latest banking number of the *Economist* (May 18, 1918) brings the figures of deposits up to the end of 1917. The growth in that year is £260,000,000, as compared with a growth of £200,000,000 in the previous year. Compared with December, 1913, the gross increase in deposits and circulation at the end of 1917 was nearly 89 per cent. By this time the gross amount of 1913 has probably been doubled.

Corresponding to these increases in notes and credits there has been an increase in prices, wages, and profits. In spite of the growth of official control of important prices, the *Economist* index number has continued to make new records, being 270 at the end of April, 1918, as compared with 116 at the end of July, 1914.

New records have also been established in the current year of war bonuses to labour. According to the *Labour Gazette*, nearly two millions of people in January-April, 1918, received net increases in weekly wages of about 5*s.* 6*d.* per head. The two millions do not include railway servants, agricultural labourers, seamen, and Government employees, who have also got large bonuses. The excess profits tax for the present financial year 1918–19, according to Mr. Bonar Law's Budget speech, is expected to bring in £300,000,000, as against £220,000,000 in 1917–18.

In the former paper (June, 1917) a close connection was traced between the increases in silver currency and the rises

in wages. The returns of the Mint on silver coinage are not yet published,* but it is well known that there has been a large increase. It is significant that a proclamation has been issued against the melting down or the hoarding of silver, and heavy penalties have been already imposed.

The price of silver has for some time been controlled, and no doubt the actual or natural price (for illicit dealings) is above the current official market price of 48*d*. per oz. The possible melting down of silver coins may lead to the issue of notes of smaller denomination than ten shillings, and another check on inflation will be removed.

The foreign exchanges with neutral countries—*e.g.*, Spain and Holland—have marked new adverse records since June, 1917.

Our adverse balance of trade has been growing, and in the first four months of 1918 was at the rate of about £770,000,000 a year. Although some deduction may be made from this figure on the ground that part of it is met by the high rates paid for our shipping, the rates paid to neutral shipping are much higher. Were it not for the credits obtained in America it would be difficult to pay for our necessary imports.

The Select Committee on National Expenditure has revealed new records of foolish extravagance and muddled accounting. New economies are partly neutralised by new leakages and partly by new claims, and our war expenditure steadily increases.

The growth of the National Debt is such that at the end of the present financial year the gross amount will probably be about £9,000,000,000. It is true that from this gross sum large deductions have to be made. There are our loans to our Allies and Dominions. Account must also be taken of the property held by the Government—*e.g.*, factories and machinery, stores of materials, food products, etc., and of arrears of taxation. But some of the loans will not be repaid for a long term of years (if ever), and the expenses of

* See Appendix B. to this chapter.

demobilisation and of repairing the wastes of war must grow the longer the war is prolonged.

As explained above (Chap. XXXIV.), the real burden of a National Debt is best realised in terms of taxation. If the war were ended next April, and the main part of the Governmental borrowings stopped, it is probable that the revenue to be derived from taxation, *i.e.*, apart from non-tax revenue, would have to be about five times as great as in 1913–14, when it reached £160,000,000.*

The last Budget of the Chancellor of the Exchequer makes a brave show in comparison with former Budgets in the present war, and the yield of revenue makes an imposing figure. But it is imposing in more ways than one. No account is taken of the rise in prices, which after the war will confront the taxpayer with a dilemma with two sharp horns. If after the war prices fall, how are we to get the same proportionate amount from income tax and other taxes? And if prices do not fall, how are we to pay for our necessary imports? If the gold standard is effectively restored prices must fall. If it is not restored, and we still go on with a *de facto* depreciated currency, what is to become of the financial supremacy of London?

The growth of the national debt and of the other financial obligations consequent on the war is viewed with complacency by two large classes of people who are blinded by two dazzling delusions. The first delusion is of those who expect the war boom to be followed by a peace boom. This peace boom is to be financed by more Governmental borrowings, nominally for productive purposes. Even these optimists, however, must admit that it will be rather difficult to start the peace boom if to meet prior charges some £800,000,000 must be raised by taxation.

The second delusion is to suppose that financial burdens after the war have no bearing on the present conduct of the

* In a speech in the House of Lords, August 5, 1918, Lord Inchcape estimated that a revenue of £700,000,000 would be required if the war ended in March or before. In the rough estimate in the text more allowance is made for the rise in normal expenditure, *e.g.*, naval and military, and for the necessary continuance for some time of abnormal expenditure.

war. Get on with the war is the cry, and let after-the-war look to itself. Sufficient to the day is the evil thereof. The moral sentiment is excellent, as is the way of delusions. But the idea that careless extravagance on the part of the State is of no present consequence because the bill has to be paid after the war is foolish. The greatest danger of the war is premature peace. The greatest incitement to premature peace is the fear of the collapse of credit and the dread of repudiation. The greatest danger to credit is the wasteful expenditure of borrowed or manufactured money.

After the depressing register of bad records we come to the more pleasing signs of improvement.

The first sign of improvement is that during the past year the rise in prices as revealed by the *Economist* index numbers has not been so rapid as in the previous years. In the first four months of 1918 the index number rose from 265 to 270 as compared with a rise from 223 to 244 in 1917. It is too much to hope that the rise in prices will be now definitely stopped, but even a slowing down of the pace is welcome.

The principal cause of the check to rising prices is the extension of Governmental control, of which the most striking example is provided by the moral courage and practical genius of Lord Rhondda. Unfortunately the control was not exercised in the beginnings of the inflation before American prices had risen. Now we have to adjust our controlled prices to the rising prices in America, also largely due to inflation. Recent statistical inquiries in the United States and Canada show that, as in this country, the rise in prices in America has followed, and has not preceded, the increases in currency and bank credits. Australia also shows the same effects from the same causes.

Another sign of improvement is the closer critical analysis of the details of expenditure and the relative statistics. We used to be told that the war bonuses to labour were given to meet the rise in the cost of living. It now appears that if we have regard to substitutes and to the changes in the art of living, the rise in the real cost of living is much below

the figure usually quoted from the *Labour Gazette*. And yet, in spite of this discovery and of the forcible reductions by Lord Rhondda, the demand for war bonuses to meet the higher cost of living still continues. Official arbitrators are still giving favourable awards. A rise has just been given of 1s. 6*d*. a day to miners above sixteen years of age, the juniors getting 9*d*. The Chancellor of the Exchequer has explained that under the new regulations the Income tax on a worker with a wife and small family and only four pounds a week wages is to be practically *nil*. He has also reduced the cost of entertainments by abating the tax on the lower-priced tickets.

The real obstacle to the stoppage in the advance of war bonuses to labour is the persistent belief that profits can bear still further advances.

It is, then, encouraging to note that in the past year the control of profits has been extended. An attempt is being made to keep down the rate of interest on bank deposits, with the view of encouraging investment in war bonds. Allowing for bonuses, however, the State is still paying more than 5 per cent. for its loans.

The list of contracts against public policy is being extended. Old contracts are being revised, and new contracts are being made on terms more favourable to the State. But it is plain, with the enormous revenue from excess profits, that there is still much room for improvement. The "earnings of management" given to the captains of war industries are very large compared with the earnings of the captains of active war. The payments for the risk of the dead capital are also very large compared with the payments for the risk of the living capital.

Some luxuries have already been suppressed or closely rationed, and more taxes on luxuries are being talked of with great animation. The bureaucrat army is being gradually combed of its redundant labour, though the Civil Service as a whole has been uplifted by war bonuses.

It must be confessed that the signs of improvement in financial methods are little more than signs of good intention

when we look to the actual growth of public expenditure. Much more drastic economies ought to be introduced if the war is to last much longer.

If, however, the financial outlook shows but faint glimmerings of new light the moral prospect is good. As so often insisted on, the worst danger of inflation with the inevitable stress on money interests is the degradation of the soul of the nation. The collapse of Russia and the consequent increase in the German menace, and even more the revelation of the nature of that menace, have restored the spirit of the nation to the heights it reached in the first days of the war. In those far-off days the nation was prepared to make any sacrifice. People went about asking what they could do to help. That old spirit is being restored and we again realise that the object of the war and the object of peace are not to be measured by monetary considerations. Money is the sinews of war, not the soul of war.

APPENDIX A.

The Commodity Values of Gold and Silver.

The *specific* depreciation of the pound sterling is shown by the rise in the price of gold as a commodity.

An authoritative survey was given by Sir Lionel Phillips of the position of gold in a speech on the South African gold industry, reported in the *Times* of June 18, 1918. The gold is paid for by the British Government at the official price of 85*s*. per oz. fine, but the small amount now permitted to be used for trade purposes had risen to about 115*s*. per oz., *i.e.*, some 35 per cent. above the official figure.

The producers of gold complain that the price of gold is fixed whilst all other things have risen in price since the war. Under normal conditions the fixity of the price of gold simply means that a sovereign contains a certain weight of fine gold with a certain proportion of alloy (for hardening

the coin). The price is fixed simply because the weight and the fineness of the sovereign are fixed by law. When general prices fell between 1875 and 1895 by about one-half the price of gold remained fixed.

The fixity of the price of gold is part of the meaning of the gold standard, but part only. Under normal conditions the maintenance of the gold standard means that the principle of convertibility is in full working order. The notes of the Bank of England, bills on London, and all the varied forms of "representative money" are convertible into gold as required at this fixed price, *i.e.*, into coins of full weight and fineness. Of course at any particular time this right is exercised only to a small extent. But the right is always there, and so long as this great principle of immediate convertibility is maintained there can be no *specific* depreciation of the actual currency.

Whenever restraints are imposed on convertibility specific depreciation is liable to occur, and unless the currency is limited such depreciation is certain to occur. In other words, gold in the market will rise to a premium.

The producers of gold in South Africa are asking the British Government to recognise the specific depreciation, *i.e.*, pay the premium on gold, or grant them a subsidy in order to keep open the low grade mines and the more expensive workings. Before such a subsidy is granted two questions ought to receive a definite answer. First, will the increase in the supply of gold improve our military efficiency or power to carry on the war? If this war test had been always applied our Government would have lessened its subsidies by many millions. The second question is: Who really pays the subsidy and who really gains by it? If this peace test had also been applied our Government would have saved many more millions. All subsidies in the last resort mean taxation, and when we leave out the money mechanism taxation simply means taking real wealth from some people to give to others.

The present position of silver also throws light on the general monetary situation. The progress of inflation

operates on the natural (*i.e.*, uncontrolled) price of silver in two ways. The monetary demand is much greater.* So great is this demand that very little is left over for commodity uses. At the same time the demand for non-monetary uses is much greater owing to the general rise in money incomes. The *nouveaux riches* both of capital and labour want more silver ornaments or more plate. The demand is further intensified by the restrictions on gold. But for the American control the price of silver would probably have reached the old parity of 60*d.* per oz.

For the time the situation has been relieved by the United States releasing its hoards of silver and issuing small Federal Reserve Bank Notes. Such relief in supply, however, can only be temporary compared with the continued rise in demand. If the natural rise in price continues Gresham's law will operate in the old-fashioned way, and silver coins will be melted down. Already, in India the rupee has passed the melting point and in Ireland the Government has issued a proclamation against melting down or hoarding silver coins. Any large withdrawal of silver is sure to be met by the issue of small notes and another check on inflation will be removed.

APPENDIX B.

Table of net issues of bronze and silver coins from the end of March, 1917, to the end of June, 1918, in quarterly returns, bringing up to date the table on p. 108.

Net Issues of Imperial Silver Coin in the United Kingdom.

Quarter.	New Coin issued.	Worn Coin withdrawn.	Net Issues.
	£	£	£
June, 1917	833,500	77,000	756,500
September, 1917	343,900	55,000	288,900
December, 1917	601,875	39,000	562,875
March, 1918	1,229,650	46,235	1,183,415
June, 1918	2,066,925	32,000	2,034,925
Total	5,075,850	249,235	4,826,615

* See pp. 92, 101

Net Issues of Imperial Bronze Coin in the United Kingdom.

Quarter.	New Coin issued.	Worn Coin withdrawn.	Net Issues.
	£	£	
June, 1917	100,530	385	100,145
September, 1917	116,145	470	115,675
December, 1917	167,410	390	167,020
March, 1918	150,715	350	150,365
June, 1918	118,200	385	117,815
Total	653,000	1,980	651,020

CHAPTER XLVI

THE PAYMENT OF WAR DEBT BY TAXATION OF CAPITAL

(*August* 7, 1918)

THE amount of our war debt is already so large and is growing so rapidly that at last our optimists are beginning to ask what it will mean in terms of taxation at the end of the war. No one expects the fighting to stop before April, and the borrowing is not likely to stop with the fighting. There will be the expenses of demobilisation and of insurance against German treachery. To begin with the peace must be an armed peace. The boom in trade and the projects of social reform will mean more expense. With so many excuses, the pleasant habit of spending borrowed money will not be easily broken.

When once normal expenditure is covered by normal revenue, and all the debt is funded and the interest and provision for redemption are paid out of taxation, the estimate of five times the pre-war revenue from taxation (say) £800,000,000, given in a previous paper, is not likely to prove excessive.

How is the money to be found? The old salutary rule that direct and indirect taxation should be increased together in some kind of reasonable proportion has been abandoned in the war. Any additions to taxes on consuming power have been neutralised by bonuses and subsidies. After the war there is little doubt that the opinion of the democracy will be in favour of throwing most if not all the burden of the war debt on the payers of income tax. During the war the income tax has been made more steeply progressive. After the war the steepening will continue.

It is the recognition of the advent and continuance of this steepening income tax that has given rise to the proposal for the taxation of capital as an alternative. There is nothing new in the idea. Just two hundred years ago, as Professor W. R. Scott shows in his recent book on "Economic Problems after the War," Archibald Hutchison made a thoroughgoing scheme for reducing the National Debt in this way, and since then other proposals of the same kind have come and vanished at intervals like new stars. The present proposal, at any rate, excels in magnitude—perhaps also it will excel in the velocity of its disappearance.

The real meaning of the proposal is to extinguish part of the National Debt so that the interest on the remainder may come within the range of manageable ordinary taxation.

The simplest plan would be to repudiate half (or any other proportion) of the debt, or, what is the same thing, to lower the interest. But repudiation and breach of contract are opposed to our most cherished ideas, and the dangers have been forcibly illustrated by Russia and Germany.

Our taxers of capital make the direct extinction of war debt only part of the proposal. By making the levy general they hope to provide funds for a still larger extinction. This method pays respect to the principle of equality of taxation as between the holders of property (above a certain minimum), although *ipso facto* it makes the inequality more glaring as between the haves and the have-nots. In these days, however, even this respect to one of the recognised principles of taxation is welcome. Even one principle partially applied is better than none. Unprincipled taxation is simple robbery. Taxation does not mean simply taking, but taking according to the general principles of government recognised by the State.

That there is need at present for pressing the distinction between "taxing" and "taking" is evident from other popular proposals for "taxation." There is, for example, nationalisation of land by the simple process of "taxing" rents to the full value—*i.e.*, taking them. In the same way, any Socialistic scheme may be realised by unprincipled

taxation of this kind. Only make the income tax and the death duties progressive enough, and spend the proceeds for the benefit of the people, and the thing is done.

Some of the supporters of the proposal prefer to speak of a levy on capital. The term levy is suggestive of conscription of wealth, with the implied idea of exceptional service to meet a national emergency. But a levy is a much more dangerous precedent than a tax. If a levy is justifiable to pay for killing Germans, why not also to save British children and their parents by giving them a healthy environment? Peace has her emergencies no less than war. The greatest happiness of the greatest number would cover a multitude of levies.

If, however, the term taxation is confused, the term capital is worse confounded. The definition of capital has given rise to endless controversies from the time of Adam Smith onwards. The question arises, Which of these meanings of capital is the best, if our object is to tax the corresponding thing or things?

We may begin with the widest meaning. The wider the meaning the more productive will be the tax and also the more equitable. One meaning of capital is so wide that it embraces every form of valuable property. When a man dies taxes are imposed on the capital value of his estate, including not only lands and interest-bearing securities, but furniture, ornaments, and other personal belongings. The advocates of the levy are very fond of quoting the analogy of the death duties. All they propose, they say, is to assume that all the people die on an appointed day, pay their duties, and come alive again.

It is more to the purpose to look to practical experience of general taxes on property in the past or the present. In former times under simpler conditions general taxes on property were common. As property became more complex the assessments became too difficult, and the general tax was broken up into special taxes. It is true that the general property tax still survives in the United States. There, however, it is not used by the Federal Government,

but by different varieties of local governments in particular States, cities, &c. Even when broken up into local taxes this general property tax has proved to be a failure. The difficulty is in the assessment and the evasion. "Can the method of assessment be made sufficiently effective to reach uniformly and equitably all forms of property, especially personal property? The answer to this question, given by the experience of the United States, is emphatically in the negative." So says Professor Plehn in his excellent introduction to finance. The opinion of Professor Seligman, the best-known American writer on finance, is still more pronounced. "The general property tax as actually administered to-day in the United States is beyond all peradventure the worst tax known in the civilised world." "This," says a commentator, "is strong language—even stronger has been used."

If the assessment is difficult when carried on from year to year as part of the tax system in localities it would obviously be far more difficult if applied only once to a whole country. Self-assessment would give a premium to dishonesty, and official valuation may be judged of by the progress made in the United Kingdom in the valuation of land alone in the search for unearned increments.

A levy on capital would involve all the original difficulties of the income tax with new ones for capital valuation. The income tax has been the subject of reforms since 1853, and is still imperfect. How is the levy to be perfected at one blow?

But the advocates of the levy in their laudable desire for equity give a still wider meaning to capital. And, so far as the definition of the term capital is concerned, they have the high authority of Adam Smith. Adam Smith brought under capital everything that yielded a revenue, and with this definition he included under capital the natural and acquired abilities of the inhabitants. This idea of including in the capital of a country the value of the inhabitants was fashionable a century before Adam Smith wrote. "The mass of mankind being worth twenty years' purchase as

well as land" is one of the gems of Petty's *Political Arithmetic* (1699). The present writer about thirty years ago applied the methods used by Sir Robert Giffen in his calculations of the material capital of the United Kingdom to the "living capital." The result was that the value of the people was about five times the value of the things. What a broad, rich field for a levy! At the end of the war if all the people came to their Soviet or whatever it was called and declared the true value of themselves and their possessions the whole of the war debt might be wiped off on one day. If —— . . .

Unfortunately the search for equity in taxation is always more productive of exemptions than of additions. On the analogy of the income tax a general tax on living capital must leave a minimum free. All the working classes would escape. Their skill is living capital, but it cannot be "polled." With the higher forms of living capital equity demands that the thing should be done, but the nature of the thing makes it impracticable. The levy on living capital when illustrated by practical examples degenerates into a bad kind of income tax. Obviously we cannot take a percentage of the value of the brains of the lawyers, doctors, accountants, and other experts, and they are to be invited (or compelled) to pay a special extra income tax for ten years or so as an equivalent. By this kind of equity the levy on capital, which is proposed to alleviate the distress of too heavy an income tax, ends up by putting the unfortunate payers, who cannot turn their capital (living or dead) into immediate cash, under an additional load of income tax. The ordinary professional man who lives up to his income (including family provision) will be in a tight place.

Perhaps it may be thought that the wide meaning of capital is too wide. But with a narrower meaning more difficulties come in. Capital, says Mill, is "wealth used for the production of more wealth"—a definition that for long held the field. To tax capital in this sense is to infringe the great rule that, as far as possible, the sources of revenue should remain unimpaired.

A tax that lessens productive power lessens also taxable capacity. The history of financial reform is largely the history of the abolition of taxes that impede production. The answer attempted to this formidable objection is that the whole capital of the country will remain unaffected. There will only be a change of ownership. What the mere change of ownership may mean in an extreme form is shown by Bolshevism. But even Bolshevism had its beginnings. It did not drop suddenly from heaven like a Zeppelin bomb.

Every business requires a certain proportion of circulating capital. The levy, if not paid in cash, must be borrowed from the banks. Does it make no difference to the business man if in some way he must mortgage his business to his banker? It is one thing to borrow from a bank to extend profitable business and quite another in order to write off a bad debt. More and more our business is done by companies. A prosperous company may issue debentures at a low rate of interest. The new capital costs little and earns much. The difference swells the dividends. But if the debentures have to be issued to meet a costly law suit or some other waste, the interest is a tax on the productive resources of the company.

There still remains the most general objection of all to the levy on capital—whatever the meaning to be assigned. The forcible reduction of the debt is intended to reduce future taxation, especially income tax. Where is the guarantee that after the levy has been made the income tax will be reduced? Is it not much more probable that when the taxing power of the country has been relieved from one drain it will be promptly used as the basis of more debt? There will be no end to the demands for State aid with borrowed money until the blindest mouths see that the margin for future taxation on which the whole security of borrowing depends has melted away.

What, then, is the true moral of this alarm about the growth of the debt and the need for a great effort to reduce the burdens? Surely the answer is that we ought to check, as far as possible, the further growth of the disorder. At

the present rate of interest every thousand millions added to the debt means more than fifty millions of taxation—allowing nothing for redemption.

We find, however, that every day reckless additions are made to the debt—at the same high rate of interest. Yet New Zealand has already shown the way to a forced loan at lower rates. Obviously a forced loan, even at no interest, would be less of a burden than a forced levy with no return of the capital.

The indirect additions to the debt are still more reckless, and show no signs of reduction. The cost of the war is largely a cost of labour—and this cost is still rising by bonuses. In the early days of the war our optimists always minimised the piling up of debt because the money borrowed was being spent in the country itself. It was the reincarnation of the old fallacy which Adam Smith called the right hand paying the left, and is now called the vicious circle. What is the use of propounding fancy schemes for the reduction of debt after the war when we are as careless as ever in adding to the debt during the war? It is worse than the old fallacy of the sinking fund. A hundred pounds at compound interest will become a hundred millions in time. The old sinking fund such as it was did grow, but not so fast as the new debt. The idea of a levy has not yet materialised at all, but the debt grows at the old pace.

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